

**Sub-Thesis: The Effectiveness
of Japanese Official
Development Assistance in
Indonesia**

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This thesis is my own work and all sources used here have been acknowledged.

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Abstract

Through an examination of Indonesia's role as an aid recipient and Japan's role as a major donor of international development assistance, this thesis will argue that the national objectives of Japanese Official Development Assistance (ODA) undermine the effectiveness of its aid. The thesis will provide an outline of Indonesia's experience with foreign aid, Japan's development of its ODA policies and how they were implemented in Indonesia, at the strategic level and through an examination of two case studies. The thesis will then finally examine the effectiveness of ODA in those case studies and conclude that recipient institutions in Indonesia need to be better placed to absorb foreign aid.

Chapter 1: Introduction

This thesis examines the world's fifth largest donor country, Japan, its Official Development Assistance (ODA) and foreign policies and development in one of the largest Japanese ODA recipients, Indonesia. Firstly, it briefly looks at Indonesia from the perspective of economic and social development and as an aid recipient.

Secondary, it discusses Japan's ODA, summarizing its history, current trends and critiques. It then investigates effectiveness of Japanese ODA with a case study of two Japanese ODA projects in Indonesia. Finally, this thesis examines how Japan can enhance its ODA qualitatively, aiming to search for better ways to lead Japan's ODA to contribute to international development and prosperity.

The Need to Examine the Link between ODA and Economic Development

While there has been previous research on how Japanese foreign aid has been commercially and diplomatically used, there is still room for further examination focused on the actual connection between ODA and economic development in the recipient country. Notable works include David Arase's *Buying Power: the Political Economy of Japan's Foreign Aid* (1995) and Marie Soderberg's *the Business of Japanese Foreign Aid: Five case studies from Asia*. Also, Robert Cassen's *Does Aid Work?* (1986) and Roger Riddell's *Does Foreign Aid Really Work?* (2008) are distinguished as research in value of the current foreign aid. In Riddell's book (2008), he concludes that while aid contributes to the reduction of poverty and the

improvement of human rights of every person, it has not been proved whether or not most ODA has worked or failed.¹ This is because, as the same argument is seen in Cassen's book, it is difficult to trace the contribution of aid to development in a certain recipient and therefore daunting to analyze aid effectiveness at the country-level. The problem here is, despite the current sharp increase in the amount of net ODA and extensive research on aid effectiveness, it is still controversial whether or not ODA can actually be a steppingstone toward further international development.

Why then do major donor countries keep providing vast amounts of ODA to recipients in the current international economic recession? What does each donor intend to achieve through its ODA? How effective has a donor country's ODA been both to the country's stability and to development in a recipient country at regional and project level? Finally, how can the donor improve the quality of its ODA with limited government budgets?

What is ODA?

Firstly, for the purpose of this paper, ODA is defined as flows of official financing administered in order to promote the economic development and welfare of developing countries. Some forms of ODA are concessional in character with a grant

¹ Roger Riddell (2008) Does Foreign Aid Really Work? P254. Oxford University Press, Oxford.

element² of at least 25 percent. By convention, ODA flows comprise contributions of donor government agencies, at all levels, to developing countries (bilateral ODA) and to multilateral institutions. ODA receipts comprise disbursements by bilateral donors and multilateral institutions.³

Japanese ODA

Distinctive features of Japan's ODA are the Asia-focused high ratio of economic infrastructure projects, yen loan bilateral aid and its aid planning and implementation carried by various governmental sectors, organizations and companies. Additionally, Japan's involvement in ODA has given the country an opportunity to not only take a leading role and have a say in the international society, but also promote its national interests abroad. Not all economically advanced countries provide foreign aid purely because they intend to reduce poverty and promote world peace. Japan's ODA is also used to advance its defense and diplomatic priorities, and the way it is distributed abroad attracts criticism on the international scene.

² According to Glossary of Statistical Terms of OECD, the grant element reflects the financial terms of a transaction: interest rate, maturity (interval to final repayment) and grace period (interval to first repayment of capital). It is a measure of the concessionality (softness) of a loan. It is calculated as the difference between the face value of a loan and the discounted present value of the service payments the borrower will make over the lifetime of the loan, expressed as a percentage of the face value.

³ OECD Glossary of statistical terms, *Official Development Assistance (ODA)*
<http://stats.oecd.org/glossary/search.asp>

A Brief Overview of Japanese ODA

Japan began to provide its foreign aid in 1954 when the country first joined the international development assistance program, Colombo Plan. Although the country has played an active role to assist developing countries since then, it was in the 1990s that Japan transformed itself from a main postwar aid recipient into one of the world's leading donor country. Japan had received the US government Appropriation for Relief in Occupied Area Fund (GARIOA) and the following Economic Rehabilitation in Occupied Areas (EROA) for five years between 1946 and 1951 as well as low interest loans from the World Bank. With foreign aid from the US and the World Bank that are equivalent to the total of 2.6 million of those times, the country accelerated industrial development and accordingly accomplished high economic growth between 1955 and 1973. While Japan has provided a large amount of financial aid to other developing countries in the last few decades, it was as late as in 1990 when this country finally completed repayments of loans from the World Bank and “graduated” from a recipient to an aid donor country. Based on Japan's experience as a donor recipient country after its defeat in World War Two and the following great economic success, this country has implemented its own foreign and aid policies, which make Japan's ODA unique.

The Rationale behind Japanese ODA

Japan has provided ODA because it realizes the links between poverty and its own security and national prosperity. The challenge of poverty threatens stability in many parts of the world and this requires economically advanced countries to actively engage in international development. International development is seen as a means in which countries are able to promote stability and therefore their own long-term national security interests.

Linking Topical Issues to ODA

This link between security and poverty can influence advanced economies around the world to take action. This link may be the underlying motivation for the 2000 Millennium Summit where 189 nations adopted and 147 world leaders signed the Millennium Declaration, the United Nations (UN), international organizations, non-governmental organizations (NGO) and the signatories have worked together as one to achieve the global time-bounded target, the Millennium Development Goals (MDGs). The MDGs are eight targets to be achieved by 2015, which addresses extreme poverty and hunger, education, gender exclusion, child mortality, basic human rights of each person to be healthy and safe, disease, environmental sustainability and global partnership for development. Japanese aid to Indonesia takes place through such high profile and broad based initiatives.

If national interests can convincingly linked to the distribution of ODA, the result is often an increase in overall development allocations. According to the Organization of Economic Co-operation and Development (OECD), as of 2008, the total amount of ODA from Development Assistance Committee (DAC) was \$119.8 billion US dollars (USD).⁴ This was double the amount provided in 2001 and the highest dollar figure ever recorded. While, due to the recent worldwide recession, some member countries from DAC have cut the annual state budget for the ODA there is a general tendency for the total ODA to increase among OECD-DAC. The largest ODA volume increases were seen particularly in the current top donor countries such as the United States, the United Kingdom, Germany and Japan. In 2008, for example, the US showed an increase of 16.8% in real terms, which is equivalent to \$26 billion USD net ODA. While Japan has had falling trends in its net ODA since 2000, the country provided \$9.4 billion USD in 2008, representing an 8.2% increase from the previous year. Net bilateral ODA from DAC to Africa has rapidly grown in the last few years and the stability and security in the least developed countries was more widely recognized as a top-priority issue in international development.

As many academics believe, poverty and crime and terrorism are closely connected to one another and the less stable and needy a country is, the more vulnerable it is to exploitation by organized crime and terrorism. In addition, contagious diseases such as an avian flu and AIDS are widely and rapidly spread in a country where sanitary conditions are lacking. The early prevention of contagion consequently will stop the worldwide spread of the disease. Meanwhile, industrial and economic development through a road and airport construction in a recipient country can bring prosperity and

⁴ OECD. Stat Extract. http://stats.oecd.org/Index.aspx?DatasetCode=REF_TOTALODA

profit a donor country and, in many cases, involvement in ODA strengthens a donor-recipient diplomatic, defense and commercial relations. World poverty reduction and improvement of sanitation conditions therefore is linked to peace and stability to the world. Greater in ODA contributions and more effective foreign aid programs can consequently bring a high return to economically developed countries. This is one of the reasons why the biggest donor country, the US, has provided a huge amount of foreign aid to pro-American countries in Central Asia and the Middle East since September 11 in 2001. This also should be one of the primary motivations for Japan's greater participation in the ODA program.

Chapter 2: Development in Indonesia

The previous chapter outlined the importance of analyzing the economic effects of ODA in recipient countries. In order to fully explain this topic, this chapter examines the development needs of Indonesia and the history of its relationship with foreign aid. The intention is to explain the conditions which lead Indonesia to accept foreign aid from multiple sources and the challenges all aid agencies face in Indonesia in ensuring the aid provided is effective. This chapter will then be followed by an outline of Japanese development assistance in order to fully explain the impact of Japan's ODA in Indonesia.

Indonesia's Natural Vulnerability

In recent times, Indonesia has suffered from numerous natural hazards including the 2004 Indian Ocean earthquake, the 2005 Nias earthquake and the 2006 Java earthquake. In the decade between 1999 and 2008, the casualties of natural disasters in Indonesia totalled 180,000 killed and 8.4 million wounded with a damage bill of \$10 billion USD. Natural disasters have had a destructive influence not only on the survivors and victims but also on later generations in Indonesia. In an interview with Antara News, Freddy Numberi, the Minister of Maritime Affairs and Fisheries, said that because of the recent natural disasters and environmental destruction in Indonesia,

20 islands vanished from the face of the earth and scientists estimate that not less than 2,000 islands will disappear by 2030 unless the government devises a solution.⁵

In addition to frequent natural hazards, Indonesia experienced a major financial crisis in 1997-98 and remains many hurdles towards economic development, political recovery and the firm establishment of democracy. Notwithstanding that Indonesia is a lower middle-income country where Gross National Income (GNI) per capita is between \$936 and \$3,705⁶, poverty remains a significant issue. The most recent poverty survey conducted by OECD in 2007 shows that nearly 6.7% of the Indonesian population lived below the one-dollar-per-day poverty line; 45.2% lived below the two-dollar-per-day level.⁷ Some economists point out that foreign aid is still vital to Indonesian economic development. According to OECD's Aid at a Glance data, members of OECD's Development Assistance Committee (OECD-DAC) provided Indonesia with ODA of a total net value of \$2.48 Billion USD during a period between 2003 and 2005.⁸ Compared with a total ODA given to other lower-middle income countries in Asia such as China (\$1.8 billion USD) and Thailand (\$1 billion USD), Indonesia remains a large recipient despite its current steady economic growth.

⁵ Antara. Nov.30.20007. <http://www.antara.co.id/en/>

⁶ The World Bank World Bank, Data& Statistics.

<http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20420458~menuPK:64133156~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html>

⁷ OECD (2008) Survey on Monitoring The Paris Deceleration: Making and More Effective by 2010, pp 22.1-22.16

⁸ Swivel Major Recipients by region of total gross bilateral ODA from DAC countries.

http://www.swivel.com/data_sets/show/1005180

Indonesia's Developmental Issues

Since Indonesia gained its independence from the Netherlands in 1949, the country has been faced with an unstable political and economic situation through the Asian financial crisis, East Timor's secession from Indonesia, armed separatist movements in Aceh and West Papua, corruption, terrorist attacks and natural hazards. Meanwhile, this country has decentralized authority, strengthened a regional autonomy program, advanced the road to democracy and, in 2004, held the first direct presidential elections. Compared with most of its neighboring countries in Southeast Asia, this is a considerable achievement. In addition, Indonesia is under the way to accomplish many of the MDGs by 2015. Indonesia's first MDGs report and National Human Development Report (NHDR) show positive socio-economic progress toward the MDGs particularly on adult literacy, infant mortality rate and child under nutrition.

However, other serious concerns remain in Indonesia's current development. Firstly, the progress is slow for the empowerment of women, which is partly attributed to Indonesia's culture and society that is still paternalistic and patrimonial. Supportably, the percentage of female rose from 0% only to 11% in the election of 2009. Indonesia has also struggled with the low percentage of the population with access to improvement sanitation, high maternal fatality rate and acceleration of HIV/AIDs epidemic. Besides, the country repeats political trial and error in terms of law enforcement and local institutions in many areas need to develop the capacity to operate their new mandate sufficiently. After all, even though the MDG targets are

achieved nationally; these targets can be failed regionally, particularly in the remote provinces and districts.⁹

According to Paul Collier, there are four traps which results in countries remaining poor; conflict; natural resources; geography; and bad governance. To be precise, low income, slow growth countries are likely to repeat civil war, to depend heavily on its natural resources and undermine accountability accelerating economic development and to be resource-scare and land-locked. Collier also points out while foreign aid helps a developing country to take off from the state of poor governance, it does not necessarily work on some fields including geography and natural resources.¹⁰ This applied mostly to Africa and Asia.

There are arguments for and against Collier's four poverty traps as development and poverty is far more complicated than these four factors and in many cases, external factors greatly affect the country's policy such as trade. However, what makes Indonesia's development sustainable, if considered from Collier's perspective, seems to depend on its strong governance and institutions that can manage the abundant resources and use foreign aid properly. The reason is because Indonesia is an archipelago with rich natural resources and a major marine transport in Southeast Asia. This enables Indonesia to engage in foreign trade and obtain foreign exchange. Notwithstanding, without the effective institutions, Indonesia can not transform these

⁹ UNDP Country Programme for Indonesia (2006-2010)
<http://www.undp.or.id/pubs/docs/CPD%202006-2010.pdf>

¹⁰ Paul Collier (2007). *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*. Pp19-37. Oxford University Press.

rich recourses and geographical advantage into positive developmental outcomes nor make the most of financial recourses for development provided by a donor country.

In addition, Indonesia, like many other developing countries, has faced internal conflicts, including those with East Timor, West Papua and Aceh. This instability, which is caused by political, religious and resource factors, has undermines its development. For instance, if one adopts Collier's theory, 30 years of conflict with Aceh province is attributed to Aceh's natural resources. That is, while these abundant natural resources were worth millions of USD at that time, only 5 % of the huge income generated by Aceh's resource remained in the regions and the rest benefited the business elites in Jakarta.

Adopting Collier analysis, there appears to be a correlation between natural resources and conflicts. However, these conflicts caused by natural resources can be possibly prevented by the functional institutions with a strong resource management and eradication of corruption. As Indonesian President Susilo Bambang Yudhoyono stated, "the fight against corruption is a top priority for Indonesia's government."¹¹ Thus the strong institutions correspondingly should be the first concern.

¹¹ BBC News. May 31.2005. <http://news.bbc.co.uk/2/hi/asia-pacific/4583557.stm>

As the World Bank's Country Partnership Strategy explains, "Indonesia is not constrained by a lack of financial resources but by a lack of effective procedures and accountability in its institutions."¹² Also, considering the fact that Indonesia is a country subject to numerous natural disasters, it is required to have the reliable institutions with the capacity to deal with disaster emergency and to achieve rapid reconstruction. According to Gerald Meier, what will decide whether a country will achieve sustained long-term growth is the institution that grants dependable property rights, handles conflict, maintains laws and order and draws a line between financial inducement and social costs and returns.¹³ A famous academic study by Burnside and Dollar also analysed the interaction between foreign aid and sound policy and it concluded good governance and firm policy are significant determinants of aid effectiveness.

Effective institutions know how to take available resources and turn them into better development outcomes. The effective institutions know how to spend budgets more wisely and build better schools, better health clinics, and better livelihoods. Therefore the key to make Indonesia's sustainable development feasible may be whether this country implements the policies and foreign aid effectively.¹⁴

¹² The World Bank Country Partnership Strategy (2009 - 2012): Investing in Indonesia's Institutions <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/INDONESIAEXTN/0,,menuPK:287084~pagePK:141132~piPK:141105~theSitePK:226309,00.html>

¹³ Gerald Meier (1984) *Leading Issues in Economic Development*. P110. Oxford University Press. USA

¹⁴ The World Bank Country Partnership Strategy (2009 - 2012): Investing in Indonesia's Institutions <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/INDONESIAEXTN/0,,menuPK:287084~pagePK:141132~piPK:141105~theSitePK:226309,00.html>

Indonesia's Need for Foreign Aid

Japanese aid to Indonesia takes place in a wider context. From the previous subsections, it is clear that despite natural resources, due to geography and economic shocks there are times where Indonesia's need for international aid is great. This subsection outlines how many countries, including Japan, attempt to meet this need. While ostensibly attempting to meet the development needs of Indonesia, it is questionable whether foreign aid has been used effectively for Indonesia's development. It is also questionable whether it has contributed to a reduction of poverty and improvement of living standards at grassroots level. This section outlines the role ODA has played in Indonesia.

The top three donors for 2005-06 were Japan, the World Bank and Australia; Japan accounted for 54.4% of the total ODA and Australia amounted to 8.2%.¹⁵ Using C. Hill's remark, although the importance of aid has gradually decreased since 1988, Indonesia has not yet accomplished one of its main fiscal objectives, which is reduced dependency on foreign aid.¹⁶ From the 1970s through to the present, aid has been mainly allocated to Indonesia's economic development and this was seen particularly during the periods of economic crisis. For instance, the average contribution of aid to

¹⁵ Ministry of Foreign Affairs of Japan (MOFA)

<file:///Volumes/NO%20NAME/Japanese%20Govenment%20Project%20with%20to%20Indonesia/MOFA%20Japan's%20ODA%20Data%20by%20Country%20-%20East%20Asia.htm>

Indonesia's development budget was around 28% during 1971-85, it amounted to 48% during 1986-96 and rose to 67% since the economic crisis.¹⁷

The reason why a developing country tends to depend heavily on foreign aid is because, according to C. Anis and S. Iman, an availability of ODA support for the national budget inspires "a lazy fiscal regime of the government". This is not an exception in Indonesia's case. In other words, Indonesia's net aid inflows reflects the government's budget shortfall and while increased aid programs and projects induces a rise in routine spending, it declines in non-oil tax income.¹⁸ This is due to Indonesia's source of natural resources which the government looks to aid in order to finance development expenditure that should be primarily used to support *routine* expenditure. In addition, the fact that aid has a negative impact on non-oil tax revenue demonstrates that the government puts less effort to revenue tax collection because donors are likely to fill the gap between government revenue and expenditure. Accordingly, the increase in routine expenditure indicates that aid project is fungible and therefore Indonesia's dependency on aid can make the country developmental unstable and economically less self reliant.¹⁹

¹⁶ Chapel. Hill. (1996) Macroeconomic Evaluation of Programme Aid: A Conceptual Framework. *IDS Bulletin* 27, no. 4 (1996): pp15-24.p46

¹⁷ Yukiko. Kuramoto (2004) Ideas and Institutions: Japan's Foreign Aid Policy (http://www.allacademic.com/meta/p_mla_apa_research_citation/0/8/4/3/1/pages84310/p84310-7.php)

¹⁸ Anis Chowdhury, Iman Sugema (2005) How significant and effective has foreign-aid to Indonesia been? ASEAN Economic Bulletin, http://findarticles.com/p/articles/mi_hb020/is_2_22/ai_n29209522/pg_10/?tag=content;col1

¹⁹ Anis Chowdhury, Iman Sugema (2005) How significant and effective has foreign-aid to Indonesia been? ASEAN Economic Bulletin, http://findarticles.com/p/articles/mi_hb020/is_2_22/ai_n29209522/pg_10/?tag=content;col1

Moreover, Indonesia has also raised a crippling debt, which amounted to \$90 billion USD in 1994. Indonesia's foreign debts have further swelled from 1275 trillion Indonesia Rupiah (Rp) in 2004 to 1,667 Rp in 2009 while their debt ratio against Indonesia's gross domestic product (GDP) had dropped from 57% to 32%. According to Fadhil Hasan, an economist of the Institute for Development and Finance (INDEF), the reason why Indonesia's external debt has increased is because the government has been allowing a growing aid flow particularly loan offers without actually needing it.²⁰ Besides, as Japan is one of the largest donor countries in Indonesia and a supplier of yen loans to the country, when the yen continues to rise against declined US dollars, Indonesia's government inevitably suffers from greater burden on an enormous yen inflow. This is because, according to *The Economist*, Japanese yen accounts for much of Indonesia's foreign debts but most of Indonesia's export earnings and foreign reserves are held in US dollars. Thus when the value of yen increases by 1% against the US dollar, it adds \$300 million USD or more to Indonesia's foreign debt.²¹ Indonesia has obtained a loan from several creditors such as Japan, the World Bank and the Asian Development Bank (ADB). Indonesia's stand-by loans up to 2009 has reached \$5.5 billion USD, i.e. \$2 billion USD came from the World Bank, \$1.5 billion USD from Japan, \$1 billion USD from Australia and \$1 billion USD from the ADB.²²

Assuming Indonesia remains largely dependent on foreign aid even after it graduated LDC and accomplished modest economic growth, it is ironic that the country owes debts to creditors and thousands of ordinary people are still brought up in poverty.

²⁰ Antara. June 17, 2009.

<http://www.antara.co.id/en/news/1245207461/news-focus-indonesias-debt-ratio-declining>

²¹ *The Economist*. March 25 1995.

²² Antara. June 17, 2009.

<http://www.antara.co.id/en/news/1245207461/news-focus-indonesias-debt-ratio-declining>

The question arisen here is whether foreign aid has been used effectively for Indonesia's regional development and has contributed to a reduction of poverty and improvement of living standard at a community level. If so, how effective has foreign aid been to Indonesia's grassroots development. Also, it is of great importance to further examine how Indonesia can reduce poverty and achieve social and economic development at a regional level through foreign aid. Identifying the current problems and re-examining the state of foreign aid is a vital step toward further achievement of Indonesian sustainable development.

Aid Projects and Programs in Indonesia

Indonesia's large population, abundant natural resources and strategic location along major shipping lanes through Southeast Asia make its peace and stability essential to many developed countries. This acknowledgement of Indonesia's importance to overall regional stability makes it one of the main recipients of foreign aid in Asian countries. As a result development organisations continuously carry out various kinds of aid projects and programs. The major sectors that donors focus on are education and health. Most of the big donors also consider disaster mitigation, effective institution as well as sustainable development in Indonesia as priority areas.

For instance, the Australian Agency for International Development (AusAID) has given priority to helping Indonesia to strengthen its democratic institutions, mitigate poverty and accomplish sustainable development. Development projects run by

AusAID in recent years include support for 2004 Indonesian election (\$15 million AUD), Australian development Scholarships (annual \$35 million AUD), 2002-2007 Indonesia HIV/AIDS Prevention and Care Project Phase II (IHPCP) (\$34 million AUD), Humanitarian and emergency assistance (\$145 million AUD) and 2002-2006 Community Development Scheme (\$20 million AUD).²³ Similarly, United Nations Development Programme (UNDP) aims primarily to improve human development to fulfil the MDGs, encourage sustainable environment management including effective use of natural resources, strengthen local governance, reduce vulnerability to crisis and support rehabilitation and recontraction in target areas; Aceh and North Sumatra.²⁴

Japan in contrast has focused heavily on the improvement of infrastructure and post natural disaster rehabilitation in Indonesia. In 2006, for example, Japan supported Regional Infrastructure for Social and Economic Development project (235 million JPY), Peusangan Hydroelectric Power Plant Construction Project (260 million JPY), The Project for Water Supply in Gunungkidul Regency of Yogyakarta Special Territory (5.25 million JPY) and the Project for Reconstruction for the Area Affected by Earthquake in Yogyakarta and Central Java (8.90 million JPY). Japan also expends its efforts on technical cooperation projects mostly in the education sector, which

²³ Australian Agency for International Development.

http://www.ausaid.gov.au/country/cbrief.cfm?DCon=3010_2150_4972_2067_3443&CountryId=30

²⁴ UNDP Country Programme for Indonesia (2006-2010)

<http://www.undp.or.id/pubs/docs/CPD%202006-2010.pdf>

includes a Higher Education Development Support Project in Indonesia and the Project for National Vocational Rehabilitation Centre for Disabled People.²⁵

According to *the World Bank (WB) 2009-2012 New Partnership Strategy (CPS) Supports Indonesia's Development Priority*, the WB is working in broadly six major areas; strengthening intuition; developing private sector; improving infrastructure; supporting community development and social protection; promoting education; and encouraging environmental sustainability and mitigating disaster.²⁶ The WB particularly put a great emphasis on building effective institutions, because Indonesia is not limited by insufficient financial recourses, rather it is limited by "a lack of effective procedures and accountabilit[ies] in its institution[s]". According to Joachim von Amsberg, Indonesia Country Director for the WB, the effective institutions consequently result in improving livelihoods for the people because it can turn budget expenditure into positive development outcomes such as better schools and better health clinics.²⁷

Some previous research conducted by Papanek (1972), Singh (1985), Burnside and Dollar (1997) and the WB (1998) also found that a positive correlation between aid and growth in a recipient country that has the good-policy environment, which has important policy implications for donors community, multilateral aid agencies and

²⁵ Japan's ODA Data by Country. http://www.mofa.go.jp/policy/oda/data/01ap_ea01.html

²⁶ The World Bank. New Country Partnership Strategy Supports Indonesia's Development Priorities. <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/INDONESIAEXTN/0,,contentMDK:21897767~menuPK:224605~pagePK:2865066~piPK:2865079~theSitePK:226309,00.html>

²⁷ The World Bank. Country Partnership Strategy (2009-2012) <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/INDONESIAEXTN/0,,menuPK:287084~pagePK:141132~piPK:141105~theSitePK:226309,00.html>

policymakers. For example, developing countries with coherent policies and high-quality public institutions have grown at 2.7% per capita GDP while those without them at 0.5% per capita GDP respectively. 1% of GDP in foreign aid normally translates to a sustained increase in growth of 0.5% per capita. Some countries with sound policies received only small amount of foreign aid yet still achieved 2.2% per capita growth. Good-management, high-aid groups grew much faster, at 3.7% per capita GDP²⁸. Therefore it is vital for Indonesia's further development to enhance institutional capacity that can maximize the effectiveness of its recourses and funds, including foreign aid, which is committed to development.

The Importance of Institutions

Indonesia's challenges in absorbing foreign development and converting this into tangible benefits for its population require institutions to be strengthened. Strong institutions are an important key to making the foreign aid effective. In economic terms, the words institutions are used separately from organisations, and Norman Uphoff clarifies what varies between these two. According to Uphoff, institutions, whether organisations or not, are complexes of norms and formal or informal rules that continue over time and constrain individual behaviour, while organisation,

²⁸ The World Bank (1998). *Assessing Aid: What Works, What Doesn't and Why*. Oxford University Press, New York

whether institutions or not, are structural actors of recognised and accepted roles.²⁹

Effective institutions manage all the legal requirements placed upon these structures and consist of elements such as political commitment, clear policy frameworks, sufficient analytical capacity and effective cross-governmental policy coordination and mediation mechanisms.³⁰

The importance of good institutions is also discussed in Lukita D. Tuwo's *Indonesia Road Map for Aid Effectiveness* and he further examines how ODA can contribute to Indonesia's aid effectiveness. That is, it is when the following three conditions are fulfilled that Indonesia can achieve further development; sound programs; instruments such as budget and procurement; and recourses including fund and human capital.

Firstly, a donor country needs to establish a firm foreign aid system and provide sound programs or projects to a recipient country. The recipient then receives these programs and transforms them into better outcomes for development. In doing so, however, it is required to have strong institutions that can deal effectively with the flow of aid in order to maximize its impact. According to Tuwo, this can be accomplished by enabling Indonesia to access international knowledge, to have the global standard of practice and to expand partnerships with other foreign countries.³¹

²⁹ Norman Uphoff. (1996) Indigenous organizations and development. *IT studies in knowledge and development Higher Education Policy Series*. P614

³⁰ OECD (2005) Policy coherence for development: promoting institutional good practice. P43
OECD Publishing

³¹ Lukita, Tuwo. *Indonesia Road Map for Aid Effectiveness*.
<http://www.scribd.com/doc/19439169/Indonesia-Aid-Effectiveness>

Participatory Development

A companion to strong institutions is participatory development. The WB highlights the importance of good governance in the following four areas to increase GNI and to bring benefits to the local people in a recipient country through ODA: the rule of law, the transparency of aid, accountability and participation of the local people in development. Similarly, C. Anis and S. Iman put great emphasis on community development in the further achievement of Indonesia. According to Anis and Iman, it can be the decisive factor in development for Indonesia to have ownership of aid policies and for donor countries to encourage Indonesia to achieve community driven development. That is, there is the notion that development is prone to be more beneficial to primary stake holders and that “development interventions based on local knowledge and experience are more likely to be relevant home-grown and therefore sustainable.”³² This idea seems to conflict with Tuwo’s argument about the importance of acquiring international knowledge. That said, applying local knowledge to achieve sustainable development and gaining global knowledge to strengthen institutions could be different stages of the same process.

From an economic development perspective, there are two major approaches in which Indonesia promotes its participatory development. The first approach is community driven development and this is fulfilled by the greater involvement in global market at community level. To be specific, if the local people are more linked to a global network of markets and their products increase in value due to international demand,

³² Kothari, Uma (2001) Power, Knowledge and Social Control in Participatory Development. P 139

this accelerates a self-supporting economy at an international level. This means people are required to bring their local value into accordance with the international standards. The second perspective is that the local government's authority is valued in terms of resource management and the local people are to practice market segmentation and have autonomy in resource management. That is, it is important to find a way to achieve devolution and to invest social capital and commons domestically.³³

According to Teiichi Aoyama, there are five levels of citizen participation in community driven development:

- 1) manipulation by biased information which does not allow citizens to participate development projects at any level;
- 2) information dissemination or release from the government sector with a low level of local participation;
- 3) consultation toward citizens where local citizens partly participate in a project planning;
- 4) active and voluntary participation and partnership for policy making, policy planning in the decision making processes; and

³³ Yoshiaki Nishikawa, Eiichi Yoshida (2009) *Chiiki no Shinkou: Seido-kouchiku no Tayousei to Kadai*. P7. the Institute of Developing Economics, JETRO. Chiba

5) citizen control stage where the local people are in charge of policy making, planning and development processes.³⁴

Some projects in Indonesia, if measured against the yardstick of Aoyama's citizen participation level, have been successful in terms of community driven development. In other words, some districts and regions in Indonesia have encouraged active participation of citizen and achieved a good partnership with stakeholders and agents when decentralization was promoted. While other projects including those at the Asahan and Koto Panjang regions discussed below have failed partly because these projects are the ones imposed by a donor and, in many cases, they do not reflect the recipient's needs nor meet their demands.

However, it is too dangerous to make sweeping generalizations about the importance of leaving decision-making for development to local governments. This is because the local governments in many districts and regions, particularly remote areas, often lack the capacity to implement legal and other mandates, establish effective policy frameworks and co-ordination, manage their own resources and arbitrate among each district. Therefore it is difficult for them to maximize their resources and make efficient use of aid provided from donor countries. Moreover, assuming the local government is empowered, the absence of appropriate accountability and transparency mechanisms often result in the concentration of power in the hands of the local elite and increases in nepotism. In Indonesia, with the vast geographic spread of local administrative centers, it is likely that there are high degrees of corruption. This is because the geography of Indonesia acts as impediments to effective communication.

³⁴ Teiichi Aoyama (2000) Environmental Impact Assessment System for Democratic Decision Making. *JBIC Symposium*. 3. Dec. 2000. <http://www.gef.or.jp/jbic/minutes/HO5-5.pdf>

The overheads associated with local administration between different population centers in an island archipelago provide opportunities for local administrators to take advantage of this vulnerability. When foreign aid is included in the context of weak control measures, this opportunity for abuse increases.

Thus, external intervention by means of foreign aid, ODA and technical assistance can be highly valuable, if it is done right. A donor country is expected to provide projects and programs based on the spirit of local self-help and to encourage further involvement of the people in development. Nevertheless, it is consistent that donor countries plan and carry out the projects and programs with the donor as a central figure, which encourages the people to participate actively in Indonesia's development while local and national institutions are developed. This oversight, balanced by meaningful local involvement mitigates against corruption.

Future Prospects for Indonesia's Development

Some academics point out that overabundant foreign aid, especially aid in the form of loans, can saddle heavy debts on Indonesia. This then requires Indonesia to reduce dependency on foreign aid. However, it is also true that Indonesia still needs foreign aid mostly to strengthen its institutions and to improve priority sectors of education, sanitation and the empowerment of females.

While there is a tendency among major donor countries to strongly emphasize the importance of effective institutions for Indonesia's further development, Japan's ODA projects do not necessarily meet Indonesia's demand.

Chapter 3: Japan's Official Development Assistance

The previous chapter outlined the development needs of Indonesia and its experience with the presence of foreign development assistance. In receiving this assistance, there are different motives at play within Indonesia. Similarly, this chapter will outline the motives behind Japan's ODA program with Indonesia. It focuses on the development of Japanese ODA policy and the interests Japan has in advancing its development agenda abroad. It then outlines current trends in Japanese ODA, and general critiques on the Japanese approach to international development. An outline of Japanese ODA is important as it provides the context where this development assistance has been provided to Indonesia, which itself is discussed at Chapter 4.

History of Japan's ODA

Indonesia is one of many countries that receive Japanese ODA. This assistance has been provided to Indonesia for decades reflecting Japan's enduring interests in the Southeast Asia region. The development of a policy that has resulted in Indonesia being provided with billions of dollars worth of ODA started from Japan's emergence from World War Two. Through its recovery, it realized a need to invest economically in the future of its region.

In 1954, Japan commenced its ODA program by taking part in the Colombo Plan to assist South East Asian economic and social development. The Colombo Plan, conceived at the Commonwealth Conference on Foreign Affairs in 1951, was to provide collective technical and financial assistance, primarily focused on human resources development to members of British Commonwealth countries. At the same time, Japan began war reparations payments to Burma under the Japan-Burma Peace Treaty and the agreement on Reparations and Economic Cooperation. Then it successively concluded reparations treaties with the Philippines, the Republic of Vietnam and Indonesia. In 1958, Japan began to provide a yen loan to India, aiming to lend and invest in developing countries in order to promote economic cooperation. 16 of 21 loan agreements that Japan made between 1975 and 1964 were for India and Pakistan. These loans were provided from the Export-Import Bank of Japan and had interest rate of 5.75-6.0% which was not qualified as ODA within the present definition.³⁵ In 1964, Japan joined OECD and pledged its dedication to achieving the fundamental aims; international economic growth; development in the third world and expansion of the world trade.

Approximately seven years later, Japan decided to integrate economic foreign cooperation into its regional foreign policy. In 1966, the country had an international ministerial conference for East Asian development in Tokyo where it began a full-scale foreign aid program to be provided to East Asia. This foreign aid program is the foundation of a later ODA program of Japan. However, Japan's foreign aid expansion during this time was aimed to establish a stronger relationship with the US and was

³⁵ Marie Soderberg (1996) *The Business of Japanese Foreign Aid- Five case studies from Asia*, Routledge. London. pp33-34

used as a political/diplomatic tool to advance the national interest. This was demonstrated by a chain reaction that Japan held the international development conference, which responded to a policy that then US president, Lyndon Johnson advocated in the preceding year and aimed to meet the US demands for Japanese co-operation.

In 1977, a year after Japan completed its reparations to the Philippines, it established the first medium-term target for ODA as a member of a great economic power for the purpose of officially giving long running economic support to developing countries. A fundamental motive for Japan's ODA was to serve the national interests, particularly to secure natural resources and expand international trade through its ODA, which Jun Inada believes is attributed to the oil crisis in the 1970s. In the book *the Current State of Economic Cooperation, and Its Outlook: The North-South Problems and Development Assistance* published in 1978, the Ministry of Foreign Affairs (MOFA) clearly stated that Japan's ODA and economic cooperation programs were to contribute the peace and stability in the world and to strengthen a friendly relationships with developing countries in order to contribute to Japan's stable economic growth.³⁶ Similarly, in 1980 comprehensive security research group (Sougou Anzenhoshou Kenkyu group) issued a statement that Japan's future diplomacy is required to have a capacity to:

- 1) prevent threats by it own efforts;

³⁶ Ministry of Foreign Affairs of Japan (MOFA), <http://www.mofa.go.jp/POLICY/oda/summary/1994/1.html>

- 2) develop relations with countries that share similar ideologies and a common interest for safety's sake; and
- 3) work on behalf of world security and stability.

Yoshiaki Tanaka interprets this as Japanese foreign aid and ODA programs to be a means of self defense and diplomatic strategies. He asserts that due to Japan's limited self-defense capacity, Japan developed a strategy for the diplomacy and national defense by emphasizing its responsibility for the world security and expanding its foreign aid and ODA.³⁷

Tanaka also points out that a reason of this dramatic increase in Japan's foreign aid which reached the sum of over \$2 million USD in such a short term was because Japan was focused on strengthening ties with the US through the perception of "burden sharing". That is, due to economic crisis hit the US in the late 1960s, the US was unable to bear a greater load of responsibility in Asia as a donor country and expected Japan to take assist with these efforts. The then American leaders encouraged Japan and other industrialized states to increase their annual commitment of ODA. In order to share this responsibility, Japan had increased both the budget for its foreign aid and scale of its recipients which was intended to strengthen the Japanese-US relationship and build up its national defense. In this sense, Japan's foreign aid program was used as the price of U.S. military protection and for prior U.S. assistance to Japan.³⁸

³⁷ Yoshiaki Tanaka (1995) *Enjyo toiu Gaikou Senryaku*. Asahi sensho. Tokyo, Japan. Pp126-144.

Steven W. Hook (1995) *National Interest and Foreign Aid*.

³⁸ Yoshiaki Tanaka (1995) *Enjyo toiu Gaikou Senryaku*. Asahi sensho. Tokyo, Japan. Pp126-144.

Since the mid-1980s, Japan has taken a current role as one of the major donor countries and implemented various kinds of foreign aid such as transferring technologies, providing emergency disaster relief and providing funds to developing countries. In the meanwhile, this country finally completed repayment of a loan in the 1990s that Japan borrowed from the World Bank after its defeat of World War Two. Thus, Japan has a unique historical background as a country that transformed itself from a recipient country into the top donor country in the world.

Through the second half of the 20th Century, Japan has changed the concepts and objectives of its ODA. From research on Japan's aid policies since 1958, Inada analyses that Japan has developed its ODA policies based on the national interest and international public interest. Here the priority has shifted from an economic orientation to a political orientation. The definition of an economic orientation is Japan's short-term and long-term economic interests which ensure security of natural resources and the strengthening of economic relations with developing countries. Meanwhile political orientation is defined as Japan's responsibility as an advanced country to improve the political stability or request or pressure from other developed countries.³⁹ This is seen in Japan's current position as the chair country for a summit and conference of the world leaders such as the Ministerial Conference on the Rehabilitation and Reconstruction of Cambodia in 1992, International Conference on African Development (TICAD) in 1993 (TICAD 1), 1998 (TICAD 2) and 2003 (TICAD 3) and the Ministerial Conference on Reconstruction Assistance to Afghanistan in 2002.

Steven W. Hook (1995) National Interest and Foreign Aid. P74

³⁹ Jun Inada. (1990) Japan's Official Development Assistance to ASEAN Countries: Its Objectives and Policy Making Process, in "Development and ODA". The United Nations University. Tokyo.

In 1992, the Japanese government adopted the ODA Charter that is the first comprehensive official policy for Japan's development aid. The ODA Charter includes "humanitarian considerations", "recognition of interdependence among nations of the international community", "environmental consideration" and "support for self-help efforts of recipient countries" as a basic philosophy of Japan's ODA. Above all, the importance of self-help is emphasized in Japan's foreign aid. However, while Japan has pronounced its philosophies and motivations on various occasions over time, Japan's current ODA policy shares similarities with the origin of its reparation system. According to Yukiko Kuramoto, Japan has used Japanese currency for grants and concessional loans since 1960s, invested in human capital in mainly Asian countries and focused on economic infrastructure projects to help Asia's economic development.⁴⁰ Additionally, Japan's ODA is still based on an "aid-by-request" policy that was adopted during the reparation period. This is a system that recipient governments are required to submit official requests to Japanese government through diplomatic channels for each project and program, which is meanwhile due to Japan's existing ODA policy focused on a concept of self-help. Furthermore, although Japan's foreign policies were greatly affected by the West particularly the US during Cold War, Japan has pursued its own economic development policies for ODA.⁴¹ This is partly attributed to Japanese own experience as a donor recipient country, following its defeat in World War Two, subsequent high economic growth and partly because of an evolving post-war national interest. In short, behind Japan's hitherto policy making on its foreign aid and ODA, there appears to be the sense that Japan's ODA has been used as a means of advancing diplomatic and security interests.

⁴⁰ Yukiko Kuramoto.(2004) Ideas and Institutions: Japan's Foreign Aid Policy
http://www.allacademic.com/meta/p_mla_apa_research_citation/0/8/4/3/1/pages84310/p84310-7.php

⁴¹ Yukiko Kuramoto. Ideas and Institutions: Japan's Foreign Aid Policy.
http://www.allacademic.com/meta/p_mla_apa_research_citation/0/8/4/3/1/pages84310/p84310-7.php

While Japan's ODA has been often viewed as measures to secure its natural resources and promote the national interest among the countries of the OECD's DAC, Japan has changed its aid and development policy with the times. Since 1997 when Japan became the world biggest donor country, it has decreased the scale for its ODA to developing countries by slow degrees under the influence of global economic recession. However, the greater expectations for the DAC members to contribute to the achievement of the MDGs have been, the stronger degree of commitment the other DAC countries was required to be made. In 2008, for example, no less than \$119.8 billion USD of ODA was provided to developing countries by DAC, which was the highest dollar figure ever recorded. While the total amount of Japan's ODA had tended slightly downward since 2000, it provided \$9.4 billion USD, which was a gain of 8.2% over the previous year. This was partly attributed to a world tendency for increasing value of ODA under the statement of MDGs goal 8: developing a global partnership for development which includes tariff and quota free access for Least Developed Country exports; enhanced programme of debt relief for HIPC and cancellation of official bilateral debt; and more generous ODA for countries committed to poverty reduction⁴².

Since Japan started taking part in the ODA program, the country has provided them with ODA to developing countries on the basis of a sense of responsibility and self-interest. While Japanese ODA often is exposed to criticism from international societies, it is based on Japan's own experience as a donor recipient and subsequent economic high economic growth, which makes the foreign and aid policies very

⁴² The United Nations,
<http://www.un.org/millenniumgoals/global.shtml>

unique. Then, in this day of economic disparities where international cooperation and partnership on development is further emphasized, for what purpose and under what policies does Japan provide enormous amount of ODA to recipient countries? While UN, international organizations and DAC members join together as one to realize the MDGs, has Japan's ODA contributed to the development of recipient countries? While in a global recession, how can Japan with limited funds provide more effective and quality aid to recipient country hereafter? The following sub-section answers these questions by first looking at main features of Japan's current ODA and criticism. It then examines Japanese possibility to improve policies and quality of its ODA henceforth so that it can contribute to not only targeted countries economic development but also the accomplishment of the MDGs.

Current Trends in Japan's ODA

While Japan has showed a tendency toward reducing the budget for its ODA since 1997 due to the 1997-98 economic crisis, the considerable ODA volume increase over the previous year was seen in 2008 in Japan. Now Japan is the world 5th largest donor country and the close attention from academics and international societies are focused on Japan's contribution to the global development. Japan's ODA consists of multilateral and bilateral assistance, which includes loans, grants and technical cooperation. Loan aid is aimed to assist developing countries in their efforts to improve economic and social infrastructure with low-interest and long-term loans; while grant aid is to give financial assistance to these countries without repayment. Technical cooperation is to help developing countries to develop human resources by

training and providing education to young experts and academics as well as running a joint project with the local government, companies and organizations. Although Japan's foreign and aid policies have varied with the change of times and objectives, some traditional characteristics of Japanese foreign policies are still in the Japan's current ODA.

One of the distinctive features to Japanese ODA is the bureaucratic framework within Japan which develops and implements aid policy that involves the Cabinet Office and no less than 12 bureaucratic actors. The Economic Planning Agency in the Cabinet Office, the Ministry of Foreign Affairs (MOFA), the Ministry of Finance (MOF) and the Ministry of Economy, Trade and Industry (METI) are the main governmental organs which establish a policy on Japan's ODA by mutual agreement and implement loan aid. The Japanese International Cooperation Agency (JICA) mostly deals with the provision of grant aid and technical assistance. These ministries play an important role along each objective and budget and they are placed on an equal and independent footing. For example, MOFA holds the authority to decide the allocation of Japan's bilateral aid to each country from a diplomatic position and emphasizes a relation with other donor countries, international organizations and recipients. On the other hand, MOF not only makes an optimum allocation to Japan's ODA and presents the general outlines of budget but also plays a role under International Organizations such as the WB and ADB. METI has been traditionally

concerned in Japan's commercial interest but it has been actively involved in technical support and environmental issues through ODA in recent years.⁴³

Although the current structure of Japan's ODA carries across many ministries and agencies, this enables each sector to share information and knowledge as well as redress imbalances in a specific views or projects. However it can also bring about a dubious flow of funds and misunderstanding among the participants or competition over division of authority, budget and profit, which results in Japan's complex mechanism of administration and inefficient performance in its ODA. In addition, due to Japan's ODA policy based on its reparation treaties, Japan has traditionally allocated its budget for bilateral ODA mostly to Asian countries and focused on Asia's economic growth. For instance, 62.4% of Japan's bilateral ODA was allotted to Asia while only 11% to Africa in 1998. Up to 2003, the relative importance of Asia in Japan's ODA had been greatly emphasized and during a period between 1998 and 2003, almost \$30 billion USD had been provided to Asian countries.⁴⁴

However, Japan's bilateral budget for Asian countries dropped to \$1 billion USD in 2007, which is equivalent to one forth of the 1998's total bilateral ODA budget to Asia. This is partly a result of the reduction of Japan's ODA due to the world economic crisis, but it should be also taken into account that Japan has shifted the emphasis on its ODA policy from national interest to international public interest and

⁴³ Bureaucratic Politics Approach to Japan's Official Development Assistance (ODA) Policy Making: Ministerial Motives and Their Relations on the Foreign Aid Policy
http://www.allacademic.com/meta/p_mla_apa_research_citation/0/8/3/0/1/p83019_index.html

⁴⁴ Ministry of Foreign Affairs (MOFA). *Nikakokukan Seifukaihatsu no Chiikibetsu. Keitaibetsu Haibun*
http://www.mofa.go.jp/mofaj/gaiko/oda/shiryo/hakusyo/08_hakusho_sh/pdfs/s2-3.pdf

from economic motives to a political motives. That is, along with the trend of ODA among the other DAC members and under the MDGs, Japan has changed aid and development policies and gradually placed more emphasis on Africa and other regions. In 2006, Japan's bilateral budget to Africa surpassed that of Asia for the first time in Japan's ODA history.

As a third feature of Japan's ODA, the country tends to have a high ratio of physical infrastructure to social infrastructure in its ODA. Japan has placed an importance on physical infrastructure such as highways, dams and school construction and supported the economic and industrial development of recipient countries. Meanwhile, the country has had less weight in social infrastructure and the role it has played in social or soft infrastructure in developing countries has been minor compared with the other DAC countries. According to MOFA, the largest use of Japan's bilateral aid has been traditionally for economic infrastructure (seisan bumon), which for example amounted to nearly 80% of the total in 1987. Although Japan's bilateral aid had gradually shifted from hard infrastructure to soft infrastructure, hard infrastructure still amounted for 31.5% of the total and only 19.7% of the total went to social infrastructure (shakai bumon) in 1990. Generally, Japan's bilateral aid has mainly consisted of construction projects while education, water supply and sanitation, which are predominant in Western ODA, made up only 10% of the total social infrastructure.

Nevertheless, with a revision of Japan's aid policy, world tendency toward emphasizing poverty reduction and the improvement of human basic needs, Japan has put greater importance on its social infrastructure. In 2007, the ratio of Japan's ODA

budget for social infrastructure was 27%, which was higher than that of economic infrastructure (23%) for the first time in its ODA history.⁴⁵ Besides that, Japan's ODA has historically provided tied aid over untied aid and loan aid over grant aid to developing countries. The ratio of tied aid is of which use is restricted to pursue services and goods from the donor country and Japan's tied loan aid has been considered as a heavy burden on the recipient country that does not have ability to repay and get out of debt. Due to Japan's political aspirations to promote foreign trade since 1972, Japanese government had aimed to export goods and build up a close tie with Asian countries through tied aid. However, responding to growing criticism of Japan's ODA system from international communities and academics, Japan's untied aid increased rapidly in the 1980s and by 1986, it had reached 71% of all aid. In 1991, the untied ratio amounted to 83.3% and 96.4% in 1999, which was the highest percentage of untied ratio in 22 DAC countries. In the meanwhile, Japan's grant aid is still low relative to other DAC countries and in 1990, for instance, grant aid accounted for only 48.6% of the total.⁴⁶

While this high rate of Japan's loan aid often attracts critiques on the international arena, the fundamental cause of this is resulted from Japan's revenue source. That is, the coffers of Japan's ODA come from the general account, investment program and national government securities, which restrict Japanese government to provide grant aid over loan aid. (q.v. table 1) As Funazu states in his book, because investment

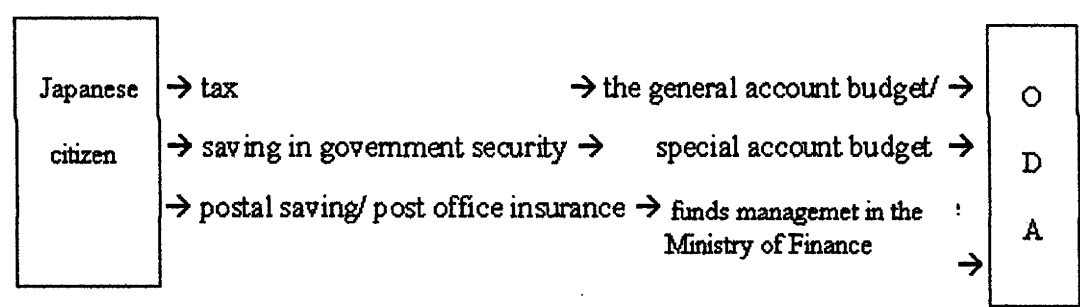
⁴⁵ Ministry of foreign Affairs of Japan. *Seifu Kaihatsu Enjyo (ODA) Hakusho 2008 Nen Ban. Nihon no Kokusai Kyouryoku*

http://www.mofa.go.jp/mofaj/gaiko/oda/shiryo/hakusho/pdf/pdfs/08_hakusho_04.pdf

⁴⁶ Seisaku Kousou Forum (The Forum for Policy Innovation). *Seifu Kaihatsu Enjyo (ODA) no Kokka Senryaku wo Tsukure*. http://www.skf.gr.jp/no43/no43_4.html

program including money from portal savings, pensions and other civilian savings are repayable to Japanese citizen, they are not to be applied to grant aid, which results in Japan’s bilateral ODA largely consisting of yen loan aid. This funding system affects quality and quantity of Japan’s ODA and possibly imposes a heavy foreign debt burden on recipient countries. Therefore, as a member of international societies, Japan will be required to reconsider how to make efficient use of funds for its ODA as well as to tap a new source of revenue to improve its grant aid ratio hereafter.⁴⁷

Table1 1. The flow of Japanese ODA



Japan typically emphasized economic growth over human social development including a rise in villager’s standard of living in developing countries, loan aid over grants aid and tied bilateral loans over untied loans. Japan’s donor approach to ODA is based on its experience as an aid recipient country after The Second World War and the following rapid economic growth by allocating a loan to physical infrastructure.

⁴⁷ Jun Funazu. (2005) ODA and the globalization of Public Finance (*ODA to Zaisei no Kokusaika*) Yuuhikaku books. Tokyo

This approach is, according to the government of Japan, the most efficient way to ensure recipient country's sustainable development and authority of ODA. In other words, it is by giving a secure source of funds, fostering a credit culture, promoting private-sector-led economic growth and maintaining stable relations with development partners that development is sustainable and the recipient country has 'ownership' of ODA. Nevertheless, on the one hand this process possibly lead to the path to economic autonomy in developing countries; on the other hand it is highly controversial in the international societies.⁴⁸ Now that the target date for the MDGs passed turnaround and there is a great fear for the miscarriage of the Goals by 2015, it is the time for Japan to revise tradition-fixated foreign and aid policies and to run audacious and carefully planned projects as opposed to the conventional infrastructure, Asia focused approach.

Critiques of Japan's ODA

In spite of well-publicized efforts to fend off international criticism of Japan's ODA, there is perception remained among the DAC countries that "Japanese ODA has been most deeply tainted toward reaping selfish benefits".⁴⁹ The radical critique is, considering the fact that the quality of aid among DAC countries is often measured in economic terms, not in terms of the success of a project, it is questionable that Japan's ODA is considered as quality aid. If quality is measured by the amount of grant aid as

⁴⁸ Bill Pritchard. Inside Asia. May 4 2007
http://insideasia.typepad.com/ia/2006/05/oda_japanese_wa.html

⁴⁹ David Arase. (2005) Japan's Foreign Aid: Old Continuities and New Direction. Routledge

opposed to loan aid and grant element, Japan is placed the lowest rank in both those lists.⁵⁰ As Coppel Orr claims, Japan's ODA seems to contribute not only to the development of recipient country's economy but also, in some degree, to the accumulation of the country's foreign debt. That is due to the high rate of Japan's loan aid. According to Orr, one of Japan's major recipient countries, Indonesia's foreign debt was \$410 million USD in 1988 and the country owed at least one-third of the total foreign debt to Japan.⁵¹ Indonesia's foreign loan from Japan has reached \$1.5 billion USD up to 2009 and it is estimated to keep mounting at this rate. Some academics criticize that Japan's loan system resembles the US sub-prime loan in a way both of them give a large loan to people/countries that are unable to repay and plagued by debts. If Japan continues to provide a large amount of yen loans to a country that does not have the ability to repay, not only the recipient country is burdened by debt repayment but also Japan digs itself into a hole.

In addition, in spite of being one of leading donors in absolute terms, Japan gives only 0.26% of its GNI, which is well below the average of DAC countries and the 4th lowest position among 21 DAC members. This is opposed to most of European ODA that tends to emphasize the provision of direct grants for the UN goals. For instance, the total amount of Japanese ODA \$9.4 billion USD or 0.18% of its GNI was calculated in 2008 while Sweden contributed \$4.7 billion USD or 0.98% of its GNI, the 0.88% of ODA/GNI ratio was presented in Norway and 0.34% in Australia.⁵²

⁵⁰ Marie Soderberg (1996) *The Business of Japanese Foreign Aid- Five case studies from Asia*, Routledge, London. P37

⁵¹ Koppel, R Orr (1993) *Japan's Foreign Aid: Power and Policy in a New Era*, Westview Press

⁵² OECD. Table 1: Net Official Development Assistance
<http://www.oecd.org/dataoecd/48/34/42459170.pdf>

Although the country has adopted the UN goal of using 0.7% of GNI for ODA, it is still a long and arduous way for Japan to achieve the UN goal without concrete time frame decided upon.

The Japanese approach might be successful in addressing the general context for economic expansion in developing country; however it is insufficient in directly addressing pressing social issues such as poverty reduction, illiteracy and women's rights in a recipient country. Traditionally, Japan has given too much weight to physical infrastructure in a recipient country, particularly in Asia, which is opposed to most western DAC countries. While net bilateral ODA to the Least Developed Countries (LDC) and social development in these countries are greatly emphasized among the DAC members, Japan has provided its ODA less than other countries to the LDCs. Primary reason for the comparatively low proportion of aid to the LDCs is the heavy priority Japan gives to diplomatically and commercially important countries in Asia which has prospect of further economic growth. Japan is almost the only country that continues to provide a large amount of bilateral aid to Asian countries such as China, the Philippines and Thailand which already graduated the LDCs.⁵³ This is because Japanese objective to promote its national interests is present in the ODA policy. Thus, Japan is far behind other DAC countries in terms of its contribution to development of the LDCs and achievement of the UN goals.

⁵³ Marie Soderberg (1996) *The Business of Japanese Foreign Aid- Five case studies from Asia*, Routledge. London. P42

While global demand for security and stability increases in a contemporary society and objectives and quality of foreign aid continue to change, Japan embraces positions on its ODA “which has been traditionally associated with Japanese thinking on the subject.”⁵⁴ That is, Japan’s economic development approach is a product of the Japanese unique concept of “sharing prosperity through co-existence (Kyozon-Kyoei)”. This means the national interests of Japan and developing countries’ accomplishment through Japanese economic development approach are not mutually exclusive but compatible. Although foreign aid as a means of responding to its high dependency on raw materials was a significant motivator of the then Japanese foreign policy, a recipient country, particularly in Asia, could enjoy prosperity brought by increased trade and foreign currency.⁵⁵ This approach was therefore created based on a concept of combined effects and mutual interests to both Japan and a recipient country.

This idea seems to remain present in current Japanese ODA policy. Supporting this, Bill Pritchard states that Japan follows the conventional method in the belief that the developmental sustainability requires a stress on long-term investments in economic infrastructure; untied loan aid allows recipient countries to select their own priorities; and a credit culture may aid in instilling principles of good economic governance at the national level.⁵⁶ In addition, due to the current economic downturn, it is understandable that Japan aims to achieve a high return and promote the national

⁵⁴ Pritchard Bill. (2006) Inside Asia: ODA Japanese Way.

http://insideasia.typepad.com/ia/2006/05/oda_japanese_wa.html

⁵⁵ Edward Lincoln (1993), Japan’s New Global Role. Washington, DC: the Brookings Institution

⁵⁶ Pritchard Bill. (2006) Inside Asia: ODA Japanese Way.

http://insideasia.typepad.com/ia/2006/05/oda_japanese_wa.html

interests by its ODA projects. However, with growing demand for international development and Japan's greater responsibility as an economically advanced country, the Japanese traditional approach toward foreign aid may not be able to meet international needs and therefore can not be fully effective. The next chapter will determine the extent of effectiveness of Japan's ODA policies in Indonesia.

Chapter 4: Japan's Official Development Assistance Projects in Indonesia

The preceding chapters have outlined Indonesia's development needs, its relationship with foreign aid, and the development of Japan's ODA policy. Now that two pieces of the puzzle have been examined, this chapter focuses on Japan's ODA projects in Indonesia. Firstly, it introduces it places the Japanese ODA provided to Indonesia in the context its overall engagement with Indonesia, it then introduces two Japanese ODA projects with the examples of the **Asahan Dam** and **Koto Panjang Dam**. Through these case studies it will examines the effectiveness of aid based on the governmental and academic evaluations. It then examines the practicality, strengths and weaknesses of Japan's ODA projects in Indonesia. Finally, it discusses how Japan can make the most of its ODA to achieve the primary objectives and contribute to the recipient country's further development, using the case study of Japan's ODA projects in Indonesia.

Japanese Engagement with Indonesia

Japanese ODA must be seen in the overall context of its engagement with Indonesia. Historically, geographically and commercially, Japan has strengthened close ties with Indonesia. Diplomatic relations between Japan and Indonesia were established in 1958 with the Signing of the Treaty of Peace. Now Japan is one of the largest economic partners of Indonesia. In the investment field, Japan has traditionally been

the largest investor in Indonesia outside the oil sector. Japan's direct investment to Indonesia between 1967 and 1990 accounted for 25% of the total cumulative investment approvals, which was equivalent to \$9.3 billion USD. Although Japan is no longer such a big stakeholder as it was ten years ago, Japan's role remains predominant and during a period between 2002 and 2006, its share in investment in Indonesia accounted for \$5 billion USD. In addition, Indonesia is a top trade partner of Japan and this country mostly exports petroleum, natural gas, oil and a mineral fuel to Japan. This accounted for 21% of Indonesia's annual export in 2007 and the total exports of Indonesia to Japan between 2002 and 2007 were valued at \$1,050 billion USD.

For actual ODA, Indonesia is one of Japan's largest recipients. Almost over 40 years from 1996 to 2005, Japan had provided the cumulative total amount of \$46.8 billion USD bilateral ODA to Indonesia.⁵⁷ Japan has given Indonesia a large amount of economic assistance over the past half a century and the country has seemingly made a major contribution to Indonesia's economic development through its ODA. For example, Japan provided Indonesia 2.2 trillion Japanese Yen (JPY) out of the total 11.2 trillion JPY loan in 2002, which was mainly allocated to the economic infrastructure and human resource development in Indonesia. In 2007, Indonesia was the ninth largest recipient country of Japan's grant aid and second largest recipient of Japanese technical co-operation.⁵⁸

⁵⁷ Ministry of Foreign Affairs of Japan. <http://www.mofa.go.jp/region/asia-paci/indonesia/index.html>

⁵⁸ Ministry of Foreign Affairs of Japan (MOFA) (1997). Japan's ODA 1997. (Tokyo: Association for Promotion of International Co-operation).pp188-189

While Indonesia and Japan has established a close and relaxed relationship, there were concerns especially among the older generation about Indonesia's dependence on Japan for its aid, development and investment from time to time. For instance, the relationship between two countries was strained in the mid-1970 when anti-Japanese sentiment aroused in Jakarta during the visit of the then prime minister, Kakuei Tanaka. This incident is known as Malari Riot (Malapetaka Lima Belas Januari) and is believed to be caused by the local disagreement against the then prime minister, Soeharto's administration, poor economic condition and foreign influence including increasing foreign investment in the country. In the interview with Jakarta News, Hariman Siregar, one of the key student leaders in the Malari Riot states that the main objective of the riot was to express their growing dissatisfaction at Soeharto's government and his regime including the spread of corruption and maldistribution of power and wealth. In addition, the rising foreign investment was considered as a factor that increased the local unemployment and worsened the economic condition in Indonesia and therefore Japan, the Indonesia's largest foreign investor of those times, was targeted by those who opposed to foreign investment.⁵⁹

To this very day there are still reservations concerning Indonesia's reliance on Japanese aid for its development. However, the relationship between Indonesia and Japan is stable and strong. This is because Indonesia still remains the focus of Japan's ODA in spite of its complex historical background as well as some criticism of Japanese aid within and outside the country. Indonesia is a reliable supplier to Japan of natural resources with major shipping lines through the Straits of Malacca and Lombok. This issue of national security and diplomacy, including a strong trade and

⁵⁹ Jakarta News (*Jakarta Shinbun*). <http://www.jakartashimbun.com/>. Stated on 24. January. 2003

investment ties, results in Japan's aid contribution to Indonesia.⁶⁰ According to MOFA, the Japanese government cites several reasons for attaching great weight to a bilateral aid to Indonesia over many other countries. That is; 1) Indonesia is a politically and economically important country to Japan and those countries have a strong historical relation with each other; 2) Indonesia occupies a major line of marine transportation for Japan; 3) Indonesia is Japanese main trade partner; and 4) Jakarta enjoys a prominent position within the international community.... therefore taking into consideration all the above, Indonesia needs large amounts of aid.⁶¹

As previous research on Japan's ODA indicates, it seems obvious that there are underlying motives for Japan's ODA behind its contribution to the achievement of the MDGs and recipient country's further development. Marie Soderberg, for instance, concludes in her book *The Business of Japanese Foreign Aid* that a donor-recipient relation is not only one-sided but rather give and take and therefore mutual. This is clearly seen in Japan and recipient's relationships considering Japan's choice of country, type of foreign aid and its aid policy and method.⁶² Foreign aid accordingly is to be beneficial to both a donor and recipient. The similar arguments are developed in David Arase's *Buying Power: The Political Economy of Japan's Foreign Aid* (1995). Assuming this is true, a main concern of Japan seems whether the country will not only have a high return through its great involvement in ODA projects but also help a recipient country to achieve further development.

⁶⁰ Hal Hill. (2000) *The Indonesian Economy*. pp92-93. Cambridge University Press.

⁶¹ Ministry of Foreign Affairs of Japan (MOFA). (1997) *Japan's ODA 1997*. Tokyo: Association for Promotion of International Co-operation. pp188-189

⁶² Marie Soderberg (1996) *The Business of Japanese Foreign Aid- Five case studies from Asia*, Routledge. London. Pp277-289

Then, how effective and successful has Japanese ODA been to improve its domestic situation in economically, diplomatically and in terms of security? In addition to its own national interest, has Japanese ODA contributed to recipient country's development and prosperity? And how can Japan make its ODA more effective and qualitative within a limited budget and source hereafter?

Case Studies: Japanese ODA Assistance to the Ashan and Koto Panjang Dams

Japanese ODA was provided to Indonesia to assist with the construction of the Ashan and Koto Panjang Dams. This aid was provided on the basis that there was an increasing demand for electricity in Indonesia as the power sector has grown dramatically in Indonesia since 1970. While construction of power was necessary to increase Indonesian standards of living, it is also of high cost and therefore not out of reach unless foreign assistance was provided. A large portion of foreign aid was therefore allocated to the power sector in Indonesia, which currently amounts for a quarter of all Overseas Economic Cooperation Fund (OECF) to the country.

Persahaan Listrik Negara (PLN), Indonesia's state electricity company, has played a dominant role to implement power projects and, while power demand increased, PLN achieved an average of 15.5% annual growth between 1970 and 1991. PLN comes under the Ministry of Mines and Energy and takes charge of construction and operation of all publicity owned power plants as well as sale of electric power to the end-users. Japan is one of major countries that provide a large amount of ODA to Indonesia's infrastructure sector such as electricity supply, dams and telecommunication facilities. Until 1999, Japan's ODA for infrastructure accounted to

32% of the total ODA to Indonesia and the biggest portion of Japanese ODA went to the construction of dams.⁶³ Over the years, Japan has implemented and carried out large-scale energy projects in this country, which includes the Asahan Hydroelectric Power Plant Project and the Koto Panjang Dam Project.

The Asahan Hydroelectric Power Plant Project

The Asahan Hydroelectric Power Plant Project is a long-term integrated project designed for:

- 1) Aluminium smelting factory with the capacity of 225,000 ton a year;
- 2) the hydroelectricity power plant located along the Asahan river west of Lake Toba in North Sumatra with capacity of 600 Megawatts;
- 3) special seaport with special seaport with three bridges, consisting of two bridges with the capacity of 16,000 deadweight (Dwt) and one bridge with the capacity of 1,000 Dwt; and
- 4) new residential area located at Tanhung Gading to accommodate 2,100 workers of the Aluminum Factory.

This project was jointly implemented by the Indonesian Government, Japanese Government and Japanese private industry through Nippon Koei Co. Ltd. The Asahan Hydroelectric Power Plant Project officially started in 1975, but the Lake Toba area

⁶³ African Forum Network on Debt and Development. The Case of Illegitimate Debt in Indonesia. <http://www.afrodad.org/downloads/Indonesia%20FTA%20final.pdf>

was the focus of Japanese, Dutch, and Soviet interests for its power development much earlier than the commencement of Japan's Asahan project.

As early as 1980, the Dutch survey team firstly investigated the Lake Toba area. In 1939, Dutch and the Netherland Indies Government cooperatively worked on planning to generate power on the Asahan river for aluminium production and in 1941, this joint venture gained the legal water right to start the project. This project was, however, suspended due to World War Two. After the war, some international survey teams, consisting of Japanese, French, American and Swedish companies, carried out further research on this area and submitted reports. In 1960, a Soviet investigation team conducted an extensive survey of hydroelectric aluminium production under Indonesia- the Union of Soviet Socialist Republics (USSR) "Economic and Technical Mutual Agreement." While relations among these two countries were strong, the power project was likely to be carried out by USSR. However, the Soviet investigation team had to leave in 1965 due to an attempted coup in Jakarta.⁶⁴

It was during World War Two in 1942 that the first Japanese survey team arrived at Lake Toba to investigate this area but Japan had not made an agreement with Indonesia on detailed investigation and design of the hydroelectric plant until 1972. At that time, Japan was eager to invest in the Aluminium production due to the then oil crisis followed by a substantial rise in the use of domestic power. In the meanwhile, the then Soeharto regime initiated a program of economic development reform, which

⁶⁴ Marie Soderberg (1996) *The Business of Japanese Foreign Aid- Five case studies from Asia*, Routledge. London. P141

aimed to achieve regional economic development, acquisition of foreign currency and domestic employment expansion. Therefore, the Japanese objective was to operate the development-and-import scheme of Aluminium production through the Asahan Project and Indonesia's motive to forge ahead with a national economic development policy coincided with this motive. Japan obtained water rights and a licence to operate the project for over 30 years as well as it received tax benefits from Indonesia. In 1975, eight years after Japanese consulting company, Nippon Koei Co. Ltd, submitted the first proposal to the Indonesian Government to undertake the Asahan study and three years later a financial agreement was made between Indonesia and Japan, Japan finally commenced this Asahan project.

The Asahan Project is owned and implemented by PT Indonesia Asahan Aluminium (PT Inalum). PT Inalum is a joint venture between Indonesian Government and Nippon Asahan Aluminium Co. Ltd, which was established in 1976. 25% of shares are owned by PT Inalum, a half of them are by the Nippon Asahan Aluminium Co. Ltd and the rest is by Japanese aluminium smelting companies and trading companies. As much as 61.5 billion JPY (\$295 million USD) in OECF loans plus another 34 billion JPY (\$128 million USD) in OECF investment was put into Asahan Project. Moreover, what seemed on the surface as a commercial transaction was actually government aid to Indonesia. The Japanese government provided large loans for the Indonesian project. (q.v. table 2)

As table 2 below shows, the Asahan Dam Project was long-term mega project largely financed by Japanese ODA, spreads over 30 years and amounts to the total cost of billions of JPY. This entire cost more than doubled the 1975's initial estimate due to a high rate of inflation that Japan provided and invested yen in Indonesia. Besides that, while this project was provided as a yen loan aid, it lacked transparency in terms of a full statement of account. This has not only incurred the mistrust of the Japanese public whose taxes are used for dubious accounts but also heavily burdened the Indonesian people who have an obligation to repay its debts. Japan has operated the Aluminium production under the 30 year contract since 1983. However, the contract term expires in three years in 2013. The Asahan Project will then be taken over by the government of Indonesia.

Table 2. Disbursement of Japan's bilateral loans for Asahan Project

Year	Project	Amount (in 100 million JPY)
1970	Asahan Hydroelectricity Power Plant	288
1976	Asahan Hydroelectricity Power Plant	2,625
1976	Asahan Development Loan (1)	2,202
1976	Asahan Hydroelectricity Power Plant	3,401
1978	Asahan Hydroelectricity Power Plant	13,700
1978	Asahan Hydroelectricity Power Plant	3,000
1978	Asahan Development Loan (2)	353
1978	Asahan Hydroelectricity Power Plant	2,149
1979	Asahan Hydroelectricity Power Plant	6,200
1980	Asahan Hydroelectricity Power Plant	12,800
1980	Asahan Hydroelectricity Power Plant	1,785
1981	Asahan Hydroelectricity Power Plant	12,100
1981	Asahan Development Project	5,340
1982	Asahan Hydroelectricity Power Plant	4,200
1982	Engineering Services for Asahan Hydroelectricity Power Plant Project	1,984
1983	Engineering Services for Asahan Hydroelectricity Power Plant Project	1,936
1986	Engineering Services for Lower Asahan River Flood Control Project	6,28
2006	Asahan Hydroelectricity Power Plant	27,642

Source: Japanese ODA Statistical Data and the Report of the Registration of Loans and Grants, Ministry of Finance, March 2007

Evaluating the Asahan Dam Project

The Asahan project is categorised as highly beneficial to Japan, with less economic value for Indonesia.⁶⁵ Considering the fact that Indonesia has produced as much as 4 million tonnes of Aluminium over 22 years between 1982 and 2003 and Japan has imported 2.5 million tonnes during this period, the Asahan project was highly

⁶⁵ African Forum Network on Debt and Development. The Case of Illegitimate Debt in Indonesia. <http://www.afrodad.org/downloads/Indonesia%20FTA%20final.pdf>

effective to the Japanese government and investors. Equally, this project can be considered to fulfil Indonesia's original intention as it contributed the country to gaining 1.5 million tonnes of newly laid-out land to develop domestic Aluminium production, increasing foreign currency earnings, raising employment (2,500 local people were employed) and achieving an increase in tax revenue.⁶⁶

Nonetheless, the Asahan Hydroelectric Power Plant Project, if evaluated from a local development perspective, is not fruitful and therefore contentious. This is mainly because the project on a whole was designed to promote the private business of Japanese corporations. The loans were mainly for the interest of the Japanese government and corporations and PT Inalum, a major beneficiary of the loans aid, is authorized to control the electricity produced from the dam. In addition, the corruption case related to the Asahan Project came into the open when the former Minister of Public Works who was a chairman of Asahan Authority Body was reported to the Corruption Eradication Commission. The Asahan Authority Body was established by the then president Soeharto to support the development of local community and the aluminium production process. However, this Authority Body consisting of the highest circles caused the first corruption case related to the Asahan Dam project that is opened to public.⁶⁷ This project therefore only primarily benefited the Japanese government, investors and a handful of elites in Indonesia but it did not assist people who had to pay debts and it did not contribute to a rise in their standard

⁶⁶ Harutaka Hashimoto (2004) *Is Japan's ODA project successful? Retrospect and prospect of Japan's ODA policy in Indonesia*. (Seikou shitato Ierunoka? Indonesia ni okeru Kokusaku ODA Project no Chuukan Kaiko) http://www.iist.or.jp/wf/magazine/0242/0242_J.html.

⁶⁷ African Forum Network on Debt and Development. The Case of Illegitimate Debt in Indonesia. <http://www.afrodad.org/downloads/Indonesia%20FTA%20final.pdf>

of living.⁶⁸ According to Binsar Panjaitan, the Tangga village headman, the local participation in this development process was very limited and what the local community were allowed to do during this period was to work as construction workers and security guards. Therefore when the project was realised, local employments were no more needed:

The promises of the Asahan Authority Body that the local people would be recruited as permanent workers in the company were only lip services.... This is what happens with big investment in North Sumatra. It does not bring benefit as all for the local communities. We are still dreaming of the fulfilment of the promises.⁶⁹

Furthermore, the Asahan Project has apparent failures, which is resulted from an ill considered scheme. Due to a small quantity of precipitation at Lake Toba area, there has been a shortage of water, which created inadequate electricity supply in North Sumatra Province and underproduction of Aluminium. Besides this, the yen dominated loans that Japan provided to Indonesia to support the Asahan Project caused considerable damage to PT Inalum. In other words, because of Japan's loan aid that requires PT Inalum to convert its proceeds in US dollar into the loan repayment in Japanese yen as well as the current rise in the value of the yen, PT Inalum is now required to return twice as much as it borrowed from Japanese government. As a result, AT Inalum has faced bankruptcy twice and a relief measure including additional investment from Indonesia and Japanese government, private

⁶⁸ African Forum Network on Debt and Development. The Case of Illegitimate Debt in Indonesia. <http://www.afrodad.org/downloads/Indonesia%20FTA%20final.pdf>

⁶⁹ African Forum Network on Debt and Development. The Case of Illegitimate Debt in Indonesia. <http://www.afrodad.org/downloads/Indonesia%20FTA%20final.pdf>

investors and major banks and deferred loans has been taken to avoid insolvency on all such occasions.⁷⁰

Up until now, the Asahan Project has achieved the original objects that are for Japan to invest in power sector and import Aluminum production from Indonesia and for Indonesia to obtain foreign exchange and expand domestic employment. However, it also has produced a negative effect on Indonesia, particularly those who do not receive benefits from the project. That is, because PT Inalum monopolizes the market and the utilization of electricity, corruption occurs and the disparity between the rich and the poor widens. In addition, foreign debts placed a burden on the local people who live in poverty and are forced to move out of the area where power plants are built. Ironically, the development project did not bring prosperity and profits to the people who needed the most. It is in three years when the Japan-Indonesia contract over the Asahan Project expires and the government of Indonesia takes over the responsibility to run the project. It might be the further local employment expansion, clearance of foreign loans and an increase in Aluminum production without environmental pollution determines whether the Asahan Project on a whole is effective or not. Thus, it would be the key to the Indonesia's development that both Indonesia and Japan push through a structural reform of Indonesia's institution mainly composed of the handful elite and encourage active participation in the operation of the development project from the local communities and people in Indonesia. This will not only help both countries to make the most of the foreign aid and contribute to

⁷⁰ Harutaka Hashimoto (2004) *Is Japan's ODA project successful? Retrospect and prospect of Japan's ODA policy in Indonesia.* (Seikou shitato Ierunoka? Indonesia ni okeru Kokusaku ODA Project no Chuukan Kaiko) http://www.iist.or.jp/wf/magazine/0242/0242_J.html.

the further development but also encourage Indonesia to tackle corruption and create a fair division of benefits from the ODA projects.

The Koto Panjang Hydroelectric Dam Project

The Koto Panjang Hydroelectric Dam Project is one of the most notorious and controversial Japanese ODA projects, which is also the first law case in the history to involving and linking Japan's ODA human right violations and environmental destruction in a recipient country. The Koto Panjang Dam Project was first proposed in 1979 and carried out the pre-feasibility study by Tokyo Electric Power Services Co. Ltd (TEPSCO) in the following year. TEPSCO then presented the study result to the Indonesian and Japanese government, aiming to sell the scheme to both countries. Responding to TEPSCO's marketing efforts and the increasing demands for electricity at a rate of more than 20 percent per annual in Koto Panjang area, the Indonesian government decided to construct the Koto Panjang Dam with the financing of the Japanese government. Feasibility Study was conducted by JICA between 1982 and 1983 and in the following year, Andalas University of Padang carried out the analysis of environment impact of this project- Analisis Dampak Lingkungan (ANDAL). Based on Japan's feasibility study and ANDAL, OECF provided a loan of 1,152 million JPY for the Engineering Service to the Indonesian Government in 1985. After several feasibility studies and a loan contract concluded between Indonesian and OECF, the construction works of the Koto Panjang

Hydroelectric Dam finally started in 1992. The project completed in 1996 at a cost of approximately 31.2 billion JPY financed by Japan's ODA.

The primary objective of the Koto Panjang Dam Project is to utilize water resources to produce electric power with 114 megawatts of the installed electricity generation capacity. The Koto Panjang Dam is located at the 10 kilometers downstream at the confluence of two main rivers. The lands of 124 square kilometers behind the dam were considered to be flooded by the reservoir. Under the construction project of Koto Panjang Dam with the 58 meters height and the 356 meters crest length, ten local villages were estimated to submerge and therefore 2,644 families were needed to be displaced from the area.⁷¹ At first, the project was seemingly fruitful considering the fact the supply of electricity increased in this area and more than 91% of households in the sampled village possessed rubber plantation after their relocation as opposed to only 55% of them owned rubber plantation on the former lands.⁷² Nevertheless, the Koto Panjang Dam Project has brought devastating effects rather than benefits to the people's lives and surrounding environment. It is very questionable whether it was necessary for Japan to provide the Koto Panjang Dam project financed by its ODA and for Indonesia to construct the dam against the indigenous people's will.

⁷¹ Kazuko Sumi. Compensation/Rehabilitation Issues of People Affected by the Koto Panjang Dam in Indonesia and the Post-Project Legal Battle in Japan's Courts.

[http://www.kotopan.jp/Documents/IAPS-Report\(Sumi\).pdf](http://www.kotopan.jp/Documents/IAPS-Report(Sumi).pdf)

⁷² Syafruddin Karimi. Local Economic Development and Resettlement Program.

<http://www.asiaoceania.org/abstract/hs/58-HS-A0766.pdf>

The Effectiveness of the Koto Panjang Dam

The greatest drawback of this project is a lack of the basic research on geographical condition in this area and insufficient consideration given to the economic and social impact on the local people and their traditional culture. Firstly, the Koto Panjang Dam did not accomplish the initial objective to produce hydroelectricity to meet the growing local demands for the power. Since the construction of the Koto Panjang Dam, the power generation has been 15% of the initial estimation and in full production for only five days, which is obviously not sufficient for the people's needs. This is partly because the Koto Panjang Dam Project was implemented only for the interests of Japanese and Indonesian government, bureaucrats and investors who took the decision without extensive consultations and practical prospects. In addition, due to the construction of the Koto Panjang Dam, the lives of 4,886 families from ten villages were forced to relocate in spite of their petition against the proposed project. Responding to the growing disagreement of the people with the dam project, the resettlement program was designed to rehabilitate affected families' livelihoods and compensate them for their lands.

The process of resettlement started in 1993 and completed in 1997 when the dam began to inundate. As the Koto Panjang Dam Project greatly risked the indigenous people's involuntary relocation, it was expected to guarantee benefit to the affected villagers. The reality is, however, the affected families now live under the risk of impoverishment. According to Philip Hirsch and Carol Warren, more than 60 % of

families in West Sumatra's Koto Panjang resettlement villages have suffered a worsened livelihood condition.⁷³

In an interview with Norwatch, Norwegian independent news services, Adhel Yesirman from the organization Yayasan Pendidikan dan Batuan Hukum Indonesia (YPBHI) strongly emphasizes the serious impacts of the Koto Panjang Dam Project on the local people and their lives. According to Yesirman, the major problem of the resettlement due to the Koto Panjang Dam construction is the barren land provided to the villagers where it is impossible for them to farm and plant. Thus, most of the people have to work in the land around the old villages to plant and harvest so that they can make a living. However, in order to return to their old lands, it costs them 1,000 Rp for the car-ride and 5000 Rp for the boat, which is equivalent to a daily pay of the workers in the area. Besides that, water is poorly supplied in the resettlement village and the people have to travel far to find or buy water. These terrible geographical conditions of the new villages have adversely affected the quality of their lives and made them even poorer. This argument of Yesirman, a lawyer and supporter of the Koto Panjang Dam victim, seems to be contrary to Karimi's findings about the villager's growing possession of the rubber plantation in the new region mentioned above. Nonetheless, this is because Karimi's research was the focus on the selected sample villages and while those who can afford to pay the authorities to have a wider choice on the land and therefore get fertile land than the rest, the rest are

⁷³ Philip Hirsch and Carol Warren (1998) *The politics of environment in Southeast Asia: resources and resistance*. P37. Routledge.

forced to sell land to get their daily food because the new pieces of land are insufficient to feed them.⁷⁴

On top of the impact on local people's lives, the project caused the destruction of ecosystem in the region. That is, the Koto Panjang region was originally rich in aquatic resources and the indigenous people earned their living by fishery. However, the construction of the Koto Panjang Dam and the subsequent environmental destruction has driven the people to change their existing lifestyle and it has divided local communities from their traditional lifestyle rooted in the indigenous cultures. In addition, while the Japanese government promised it would protect indigenous animals, endangered species such as Sumatra elephants and tigers that were displaced because of the dam construction, most of the Sumatra elephants and tigers are now starved to death due to a lack of foods. Due to the dam project, a large amount of trees rotted and fishes disappeared, which not only caused to impair quality water of the reservoir but also caused a concern about a plague of wigglers followed by spread of malaria epidemic. This can be an adequate reason why the environmentalists and conservationists along with the local students and academics have supported the villagers and fought together against Japan's "crime against humanity" that lies behind its ODA project.

Faulty planning and implementation of the Koto Panjang Dam Project is also seen in the unfair compensation for the affected villagers. Based on the resettlement program,

⁷⁴ NorWatch. *NorWatch newsletter no. 3*, March 1999.
<http://www.kotopan.jp/13%20media/20020906NorWatch.html>

the affected families were to be granted compensation for their lands. However, the amount of compensation that Japanese government proposed was too low for the affected villagers to willingly agree with. As an example, while the price of land for vegetables, rubber and other tree crops was set at 30 Rp to 50 Rp per square meter, the compensation for each producing rubber tree was set at 2000 Rp, which is equivalent to one twentieth of the original value. In addition, the compensation for one coconut tree was set at 4000 Rp that values nearly one hundredth. However, in spite of the villagers' dissatisfaction against the level of compensation, the Indonesia and Japanese Government forced the people to sign inventories of lands and houses without having notice of the compensation amounts.

The UN Committee on Economic, Social and Cultural Rights (CESCR) in 2001 notes “with regret that the traditional lands of indigenous peoples have been reduced or occupied, without their consent, by timber, mining and oil companies, at the expense of the exercise of their culture and the equilibrium of the ecosystem.” It also highlights the importance of the local participation in decisions affecting their lives. To be precise, CESRP encourages the state to ensure that the development projects are carried out upon proper consultation and with the prior consent of the local people. In spite of increasing international recognition of the human right of the indigenous peoples on the process of developmental project, Japanese ODA does not accommodate and respect to the local people and lacks accountability for decisions

made. This is highly disapproving in addressing the concerns of the indigenous peoples with regard to development intervention.⁷⁵

While the Koto Panjang Dam Project is considered as one of the most well known examples of Japanese ODA for its diplomatic and commercial purposes, it is doubtful whether or not this project brought benefits and prosperity even for Japan. That is, this is the first legal action on the history that Japanese government, JICA, JBIC (merged with OECF in 1999) and cooperating companies were sued by a recipient country for its ODA project and Japanese government is more strongly condemned for its aid and foreign policy by international society. It seems not only Japan has not achieved an ulterior motive in providing the ODA projects as a means of diplomacy but also the country has been losing its face in international arena. Needless to say, some of the Japanese consultant companies and stakeholders have made a high profit out of its involvement in Japanese ODA projects. However, the point that should be underlined here is that, as Marie Soderberg mentioned above, a relation between a donor and recipient is not one-sided but mutual. In other words, it was the Indonesian government and a sprinkling of the elites at national and regional level who exploited the ODA projects and financial resources provided by Japan, which reflected the then Suharto regime and Indonesia's bureaucratic institution full of corruption and inefficiency.

⁷⁵ United Nations. Committee on Economic, Social and Cultural Rights (CESCR). Poverty and the International Covenant on Economic, Social and Cultural rights. 10. May. 2001
<http://www.unhchr.ch/tbs/doc.nsf/0/518e88bfb89822c9c1256a4e004df048?Opendocument>

According to Pauh Tanjung, a villager affected by this project, there were some cases of corruption reported behind the resettlement program and compensation system. For instance, the former village leader, Haji Syukur, is suspected to have received compensation of more than 300,000,000 Rp, which was hundreds times as much as the rest of the affected villagers, because his property in Tanjung Paul was registered to be compensated. The same process was applied to all of his kinship and none of them were denied compensation for their belongings and properties.⁷⁶ Moreover, the regional authority body gave the leaders of eight villages, who at first disagreed with the resettlement program, motorbikes as an incentive to consent to the resettlement and the amount of compensation for their lands. The authorities then brought documents which they wanted the village inhabitants to sign without proper explanation of what the document was. Not all of the village chiefs signed this and many do not even remember if they have signed this. However, after a meeting with the village leaders, the authorities presented a letter of consent for signing to the local villagers and they threatened them by saying that if they did not sign and agree, they would not get any compensation at all. Many signed the documents on belongings and compensation rates and the authorities used these signatures to receive OECF's funding, without these affected families' recognition.⁷⁷ Up until now, as many as 168 affected villagers are waiting for the compensation provided, but this has not yet realised.

A serious defect in the Koto Panjang Dam Hydroelectric Project is the inevitable effect resulted from Japanese excessive pursuit of its national interest and disregard of

⁷⁶ NorWatch. *NorWatch newsletter no. 3*, March 1999.
<http://www.kotopan.jp/13%20media/20020906NorWatch.html>

⁷⁷ NorWatch. *NorWatch newsletter no. 3*, *March 1999*.
<http://www.kotopan.jp/13%20media/20020906NorWatch.html>

the local people's lifestyle and environment as well as the Suharto's bad governance. Most of the compensation has disappeared on its way through the corrupt bureaucracy before it reaches the people who really need it. The documents about belongings signed by the village inhabitants were also manipulated by the committee.⁷⁸

Although the Koto Panjang Dam Project is not one of the major or most successful projects financed by Japanese government, it was in the world spotlight as the first law case that a recipient country took Japan to court for its ODA with this case still being tried at a higher court in Japan. This incident is a huge blot on the history of Japan's ODA, but with this as a start, Japan in transition is expected to re-examine and consider how it can improve the implementation of its ODA in order to avoid such incidents in the future.

How Effective and Practical Has Japan's ODA Been to Both Japan and Indonesia?

While Japan's ODA system and method often attracts criticism from the international society and dissenting voices of how to use the state coffers in the worldwide recession is heard among the general public, the government of Japan maintains a positive stance on its involvement in the ODA project. This is because there are motives for Japan's ODA behind its contribution to international development and achievement of the MDGs. According to a survey conducted by *the Kokusai Kaihatsu Journal*, while Japan's aid motivation should be humanitarian and altruistic,

⁷⁸ NorWatch. *NorWatch newsletter no. 3*, March 1999.
<http://www.kotopan.jp/13%20media/20020906NorWatch.html>

many of the Japanese aid experts who participated in the survey questioned whether the ultimate objective for Japan's ODA is to promote the national interest, including securing natural resources and increasing investment, through strengthening relationship with other countries.

The case study of Japan's ODA projects at the Asahan Dam and the Koto Panjang Dam also demonstrated Japanese commercial and diplomatic purposes behind its ODA project and Japanese-Indonesian special relationship developed for the mutual benefits. That is, although Japanese involvement in the ODA program has not directly brought prosperity and high returns to the Japanese citizens, Japan has expanded foreign trade and secured the national resources. Some of the Japanese companies and investors has also made big profits through the ODA projects as a result of providing a large amount of ODA to a targeted country. Additionally, due to the Japanese ODA system which is mostly financed by the nation's coffers and postal savings, Japan has provided a low grant element of yen loan aid to a recipient country and not much loss can be suffered. Thus, it is not an exaggeration to say that Japan has attained the objectives of a participation in the ODA program if its true basis is to further Japan's own national interests. However, the quality of Japanese ODA, if evaluated from humanitarian perspective, has not yet reached the global standard among DAC countries. Therefore, the country has not yet fulfilled its responsibility as a world economic power nor contributed greatly to the achievement of the MDGs in terms of aid effectiveness on the international development.

Meanwhile, Japanese ODA has not been very effective to the regional development and those who need the foreign assistant the most in Indonesia. This is because the financial resources including Japanese foreign aid has been, in many cases, manipulated by corrupt governments and bureaucracies in Indonesia. Also, the assistance provided by Japan disappears before it reaches to the local people. This is mainly because Indonesia's institutions do not possess the administrative competence nor have a capacity to make effective use of the development project. Thus, it is very challenging for both Japanese and Indonesian government to plan and implement the ODA projects effectively unless they have a feasible project, the sound government and strong institutions. Also, a lack of extensive research and insightful aid scheme as well as little regard for the influence upon the indigenous people's lifestyle and their surroundings has caused a huge damage to a recipient country, particularly those who are in needy circumstances. Accordingly, Japan's immoderate insistence on promoting the national interests has prevented Indonesia's social and economic development at a community level.

The Asahan Dam Project and the Koto Panjang Dam Project are only two examples out of hundreds of Japanese ODA projects and these are not a whole picture of the current Japan's ODA system. However, as seen in these case studies, Japanese ODA will possibly produce a stronger effect on Indonesia's development when Japan sets aside the national interest and Indonesia has a full system in place to receive the aid flow and to encourage a greater participation of the local people in a project planning, implementation and decision making.

How can Japan's ODA Improve its Quality and Contribute Sustainably to Development in a Recipient Country?

While the involvement of Japan's ODA program brings prosperity to the country, it often causes a negative impact rather than positive effect on the local people's lifestyle, culture and environment. This is partly attributed to Japanese inconsistent aid policy, shortsighted development scheme and a twofold purpose behind the involvement in the ODA program. In addition, without strong institutions in a recipient country, foreign assistance is misappropriated by corrupt elites before the local people have a share in the benefit of the foreign assistance. It is sine qua non that a recipient country must have the capacity to receive the foreign assistance to cope with the administration consequences that flow from a flood of foreign aid. This enables recipient countries to utilize this assistance properly for Indonesia's further development. Therefore effective recipient institutions are a decisive factor to determine whether ODA projects contribute to effective development in Indonesia.

Supporting this, Kiyokazu Koshida (2006) highlights Japan is now required to re-examine the current state of the ODA program and its effects on recipient countries. According to Koshida, the quality of ODA was heretofore evaluated based on a ratio of grant aid, grant element and untied rate and therefore it was the general recognition among DAC members that the higher a rate of grant aid and grant element index are, the better the ODA project is. However, now that Japan, like other developed countries, is slowly coming out of the current global economic recession and faces difficulties to find a means to provide ODA, a product and effect on the recipient's

country rather than good conditions of the project decides value of the project. In other words, with the severe funding limitations, the top priority of Japanese ODA projects should be to ensure sustainable economic development in a recipient country at a grassroots level rather than to provide abundant financial resources or a large number of projects that might not bring any benefit to the people. This, to be specific, means that Japanese quality ODA should primarily encourage recipients to carry through structural reforms through its intervention and monitoring in the domestic policies as well as institutions upon mutual agreements.

To achieve this, it is vital that the Japanese government restructure its bureaucratic ODA system. Likewise, it is a priority issue for Indonesia to prioritize aid projects that produce positive effects at the local level. It is also necessary that the country strengthens institutions to make the most of the projects provided. When all the conditions are established, it will be a time when participation of the locals in planning and implement the project should be promoted and Japanese ODA project works promptly and effectively in Indonesia.

In addition to improving the effectiveness of Indonesia's institutions and making Japanese ODA policy more consistent, the type of ODA projects Japan provides seems to be a key to improve the quality of Japan's ODA. That is, there are many arguments that Japan should channel more of its ODA into addressing the basic needs

of social development and poverty reduction and allow more of the financial and infrastructural requirements to be satisfied through the market in a recipient country.⁷⁹

Some of this can be achieved by shifting foreign aid to social sectors and by focusing more on the countries and people that need it the most. However, it is also worth mentioning that Japan has traditionally provided a yen loan focused on infrastructure projects to recipient countries and due to the Japanese ODA resource financed by the state coffers and public postal savings, it is difficult for Japan to allocate its funding for the ODA to a grant aid focused on social infrastructure. However, assuming Japan continues to provide a yen loan on the hard infrastructure basis as in the past, it is important the country changes its approach to launching the project. For instance, the Asahan Dam Hydroelectric Project and the Kato Panjang Dam Hydroelectric Project were fruitless attempts in terms of Indonesia's regional development. This is mostly attributed to Japan's insufficient research on the targeted area, disregard for the indigenous people's human right and excessive pursue of the national interests as well as Indonesia's bad governance. Nevertheless, these dam projects could have made a profound impact on the local people if Japan has had a comprehensive grasp of the project and given Indonesia an inclusive support from the construction of the dam to the managerial strategy for the power plants including establishing electric rate and instructing management policy.⁸⁰ These lessons of Japan's fault for its imperfect projects should be therefore applied to the next.

⁷⁹ Tatehiko, Kondou. ODA and MicroFinance (ODA to Micro Finance).
<http://www.mof.go.jp/finance/f1609b.pdf>

⁸⁰ Kiyokazu Koshida (2006) Re-examination of a partnership between ODA and NGO (ODA to NGO no Partnership Saikou) in Examination of Japan's ODA. Pp107- 178

As another element of aid effectiveness, Tatehiko Kondou points out the significance of local involvement in development project and an economic cooperation between local government and external partners. According to Kondou, Japan's economic development approaches contain the following mingled objectives:

- 1) a self-help effort system;
- 2) mutual interests between Japan and a recipient;
- 3) a state led economy and long-term development plans;
- (4) efficient public- private cooperation;
- 5) an aim to establish Asian economic bloc in the future whose motives can be achieved by a partnership between local government and external actors.

That is to say, local participation and efforts are inseparable from its own successful development. The role of external partners, namely donor countries, is to help and provide what local ownerships need for their sustainable development. Foreign capital and advice, especially advanced technology from developed countries, would not be used effectively unless the people show a willingness and commitment to carry their own economic development projects.⁸¹

⁸¹ Tatehiko, Kondou. ODA and Micro Finance (ODA to Micro Finance)
<http://www.mof.go.jp/finance/f1609b.pdf>

Foreign Aid and Non-Government Organisations

Similarly, Kiyokazu Koshida puts a great emphasis on the importance of Japan's partnership with Non Government Organizations (NGOs) in order to achieve the quality ODA. According to Koshida, there are two major reasons why the Japanese government should provide a larger amount of funds and strengthen partnerships with NGOs. Firstly, NGOs have generally wider knowledge about the local people, environment and their culture in a recipient country and they are more likely to provide effective and practical assistance to the people at the grassroots level. The partnership between Japanese ODA and NGOs are therefore complementary to each other. This not only produces good results to Indonesia's further development but also helps Japan to regain the trust from the general public, recipient countries and the international society. Secondly, active support for its NGOs gives Japanese government an opportunity to re-examine the present state of the ODA system and adopt a radical foreign aid reform if needed. This is because while Japanese government provides ODA as a means of a national strategy, the ultimate objective of foreign assistance from NGOs is to obviate the global need for ODA by working on a rise in the standard of living in development country and eradicating poverty through the world. As a good example of this, humanitarian assistance Japan provided to East Timor after the conflict was mostly through international organisations and NGOs. This is not only because Japan lacked a clear policy and deliberate decision making on humanitarian aid but also because these international organizations and the grassroots of NGOs had extensive networks of collaborators and financiers in the stricken area. Compared with NGOs in other DAC countries, Japanese NGOs are

poorly funded and in difficulty to run its own project even if it is a worthwhile scheme. Therefore coordination between the government and NGOs diversify Japanese international cooperation, which results in a higher level of aid effectiveness within a limited funding.⁸²

Micro Finance

The last point that should be underlined to make Japan's ODA more effective is the significance of micro finance in a recipient country. To be precise, as the necessity of microfinance in a developing country is internationally and domestically urged among academics and some governmental authorities, Japan is more expected to adopt a full-scale of microfinance. As widely recognized, microfinance is the provision of financial services to low-income clients, mostly destitute families and female farmers who lack access to banking services. So far the potentiality of "two-step loan" system where Japan grants a loan to the needy people through a recipient government and financial institution has been discussed among the Japanese bureaucrats and politicians and Japan has shown a positive attitude toward microeconomics. However, the amount of loan provided with Japan's two step loan system is too large to perform a function at full efficiency and meet the original objective of microfinance.

⁸² Kiyokazu Koshida (2006) Re-examination of a partnership between ODA and NGO (ODA to NGO no Partnership Saikou) in Examination of Japan's ODA. P161

According to Kondou, a main reason why microfinance is effective to Japan and a recipient country is because microfinance is consistent with Japanese fundamental philosophy of its ODA in self help effort. That is, because microfinance has a structure where the client should earn income by a small business, save some of the earnings and general further profits, it can support domestic currency system and encourage self help efforts as opposed to dependency upon financial resources provided by a donor which is seen in the existing ODA system. In order to achieve all-out effort through microfinance is, however, the country need to establish permanent local institutions. In addition, the local government is expected to enable sustainable financial services and the shortage of effective institutions can be a key factor that delays development and progress in that country. Thus the strong institution is again considered as a decisive element of aid effectiveness. In short, it is foreseen that Japanese ODA projects will be more effective and beneficial to Indonesia's grassroots development when the government of Japan and Indonesia meet the following factors; Japan's coherent ODA policy and comprehensive aid scheme; a close partnership with NGOs; greater coordination with the local government; and Indonesia's effective institution as well as a greater degree of local participation in development projects.

Chapter 5: Conclusion

Japan's ODA program is highly controversial and the quality of Japan's aid is questionable. An examination of the impact of Japanese ODA in Indonesia, particularly the case studies discussed in this thesis, reveal the issues that stand in the way of true effectiveness. There are compound reasons that explain why Japanese governments, like others, spend huge amounts of money from the coffers of the state to assist developing countries. One reason is the contribution to the achievement of the MDGs from humanitarian perspective- it is considered as an obligation of wealthy nation to help poverty alleviation and improve the standard of living elsewhere in the world.⁸³ Without exception, Japan also includes this justification in its policy statements and explains its obligation as a world economic power is the great consequence of Japan's involvement in the ODA program.

In this context, it goes without saying that the aid given by Japan should reach the people and countries that need it the most and should help those who suffer abject poverty. In reality, however, the motive of ODA often includes the national interest and does not simply reflect a nation's compassion and altruism to developing countries. It is clearly seen in a relationship between Japan and a recipient, Japanese aid policy and method as well as a type of program and assistance that Japan provides ODA to a recipient country in pursuit of national interest. This is because foreign aid is often used as diplomatic, commercial and political measures and a donor-recipient

⁸³ William Nester (1992) Japan and the Third World.

relation is rather reciprocal. That is, Japan provides a huge amount of ODA as a means of securing its natural resources, establishing stable relationships with neighboring countries and welding its stronger presence on the international arena. In the meanwhile, Japanese ODA projects seemingly bring a lot of benefits to a recipient country because these projects contribute to expanding domestic employment, promoting the acquisition of foreign currency and raising local awareness about development, which eventually encourages economic growth in the recipient country.

On due consideration of the Asahan Dam Project and the Koto Panjang Dam Project, the Japanese government provided a considerable amount of yen loans, which resulted in Japan promoting its profitable investment, stimulating local Japanese capitalized companies and increasing the imports of Aluminum that is supposedly produced by the dams financed by Japan's ODA. Equally, Indonesia obtained a better supply of electricity and stimulated employment by the construction of these dam plants.

However, it is also fair to say that foreign aid which is intended to assist the poor does not always assist those who actually need it and, in many cases, is more beneficial to the donor and only a handful of elites in a recipient country. To make matters worse, recipient countries are, in some cases, burdened with repayments due to Japanese government loans and plagued with foreign debt due to the Japanese ODA system. To prove this, both the Asahan and the Koto Panjang Dam were constructed by a huge amount of yen loan and, regardless of its actual effectiveness, the Indonesian people are bound to repay the debt for decades to come. This is partly attributed to a fundamental idea of Japan's self-help aid based on yen loans, its infrastructure

focused aid projects, aid funds borne by the public purse and Asia-centered aid allocation. As a result, while the involvement of Japan's ODA projects, in many cases, brings high returns and economic revival to the country, it is not beneficial to the people and local communities from developmental sustainability perspective.

In addition, without effective institutions in a recipient country to absorb foreign assistance and sound aid projects provided by donors, foreign assistance is diverted by corrupt politicians, bureaucrats and national/local elites to their own pockets before it is rendered to the people. Eliminating the corruption among these bureaucrats and a handful of elites is the first priority to Indonesia's development and further achievement. The case studies mentioned above demonstrate some bribe cases related to the dam projects. In many cases, politician, bureaucrats, elite businessmen and local authorities make illicit use of financial resources including ODA and the needy people can not participate in the profit produced by foreign aid. For example, in Aceh, it received approximately \$6 billion USD foreign aid after the devastating Indian Ocean earthquake in 2004. However, there was a global concern whether money provided was used properly and, if so, how effectively it was spent for the post-disaster reconstruction and further development. As these examples illustrate, the financial resources for Indonesia's development often disappear before it reaches to the local people and communities due to the corrupt government and institutions. Therefore, Indonesia is required to establish stronger institutions that are capable of dealing with the flow of aid, raising the level of transparency in the management of foreign aid and making the most of the financial resources provided the country for further development.

Over the years, Japanese ODA has attracted criticism from the international societies and its own value has been being questioned. That is traditionally attributed to Japanese aid system on the basis of a yen loan, the type of aid projects focused on the hard infrastructure, a high rate of grant element and a choice of recipient country that has a closer diplomatic and commercial relationship with Japan. It is understandable that the country intends to promote its national interests through the involvement of its ODA project because the ODA funds mostly come from the national coffers and public saving and therefore it needs to realize some kind of profits on behalf of the general public. However, it is also a donor's obligation to ensure that the foreign assistance provided by Japan brings a positive effect to the recipient country, particularly those who live in grinding poverty. In other words, as long as Japan contributes to ODA projects, either it is a grant or loan, it has to be beneficial not only to Japan but also the recipient.

To produce the desired result through the ODA project, Japan is now expected to re-examine the present and future state of its ODA system. To be precise, Japan's future ODA needs a coherent aid policy and comprehensive development scheme, a closer partnership with a recipient's local community, a greater degree of cooperation with a grassroots NGOs and a change in its approach toward the project management and monitoring. When the recipient country and Japan meet the necessary and sufficient conditions to make the most of the ODA program, these countries then should join together to encourage the participation of the local people in planning, implementing and decision making on development.

In conclusion, the key factors that determine whether Japanese ODA projects produce a strong effect on a recipient's grassroots development is Japan's consistent aid policy and a recipient's ability to absorb the flow of aid. Thus, sound Japanese projects based on prior feasible research, consultation and consent of the local people, coordination with NGOs and the local recipients as well as effective recipient institutions are of great importance to improve the quality of Japan's ODA to Indonesia.

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